# Table of Contents

## A Report on the 1995 Financial and Compliance Audit Results

May 1996

# Table of Contents, concluded

# Table of Contents

## Detailed Findings with Managements' Responses

# Key Points Of Report

## A Report on the 1995 Financial and Compliance Audit Results

May 1996

### Key Facts And Findings

- The information contained in the financial statements of Texas' *1995 Comprehensive Annual Financial Report* (*CAFR)* is presented fairly and can be relied upon to evaluate the State's financial condition.

- Material weaknesses continue to exist in the control environment at the following entities:

  - Texas Southern University's Financial Assistance Office
  - Texas Commission on Alcohol and Drug Abuse

- Material weaknesses were identified in certain elements of the internal control structure over the *Food Distribution* (CFDA 10.550) program at the Texas Department of Human Services

- A material weakness was identified in certain elements of the internal control structure over the general purpose financial statements at the Comptroller of Public Accounts

- Material noncompliance with federal program requirements was identified at the following entities:

  - Texas Department of Protective and Regulatory Services
  - General Services Commission
  - Texas Department of Housing and Community Affairs
  - State of Texas, as it relates to the *Federal Family Education Loans* program

### Contact

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*This project was conducted in accordance with Government Code, § 321.013(c).*

# Executive Summary

1995 Financial and Compliance Audit Results

SAO Report No. 96-063

May 1996

# Executive Summary

## Clean Audit Opinions

### Financial Statements

The information contained in the financial statements of Texas' *1995 Comprehensive Annual Financial Report (CAFR)* is presented fairly and can be relied upon to evaluate the State's financial condition. Most of the agencies and universities we visited have controls in place to protect the State's resources.

### Federal, State, and Bond Compliance

The information contained in the *1995 Financial and Compliance Audit Results* report indicates the State generally has controls in place to ensure compliance with federal, state, and bond requirements.

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## Texas Is Big Business

At the end of fiscal year 1995, Texas reported the following:

- total assets of $109 billion (an increase of 3.6 percent)
- total liabilities of $26.5 billion (a decrease of 9.0 percent)
- total fund balances and retained earnings of $82.4 billion (an increase of 8.2 percent)
- total revenues of $39.5 billion (an increase of 16.3 percent)
- total expenses of $38.5 billion (an increase of 16.1 percent)
- 283 bond issues outstanding totaling $10.2 billion (an increase of over $208 million)
- 675 Federal Financial Assistance programs totaling $15.8 billion

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## Strong Internal Controls Enhance Operations

Highlighted below are internal control areas which need to be strengthened. Strong internal controls help ensure that:

- assets are adequately safeguarded
- funds are spent as intended
- information is accurately reported in the financial statements

### Material Weaknesses[1] Continue to Exist at Two Entities

***Texas Southern University*** has not corrected a material weakness in the Student Financial Assistance Office. This weakness was originally identified in fiscal year 1993. A lack of coordination between departments, ineffective policies and procedures, and personnel practices are all contributing factors

[1] A **material weakness** relates to operations as a whole. It results when a lack of procedures exist which could allow large errors or illegal acts to occur and not be detected during the normal course of operations.

to the control environment material weakness. The office administered $41.5 million in financial aid for *Federal Family Education Loans* program (CFDA 84.032) and the *Federal Pell Grant Program* (CFDA 84.063). Over 75 percent of the University's enrollment participated in student financial aid in fiscal year 1995.

The ***Texas Commission on Alcohol and Drug Abuse*** continues to have a material weakness in the control environment[2] over the administration of state and federal funds, including the *Block Grants for Prevention and Treatment of Substance Abuse* (CFDA 93.959) program. Appendix 3 of the *1995 Financial and Compliance Audit Results* report discusses weaknesses and information disclosed during recent audits. Significant changes have occurred in senior management and actions are being taken to address the material weakness in the control environment.

## Two Additional Entities Have Material Internal Control Weaknesses

The ***Comptroller of Public Accounts*** has a material weakness in the controls over the current financial reporting system used to compile the State's *Comprehensive Annual Financial Report (CAFR)*. Reporting errors in the original draft of the CAFR for the fiscal year ended August 31, 1995, were caused by:

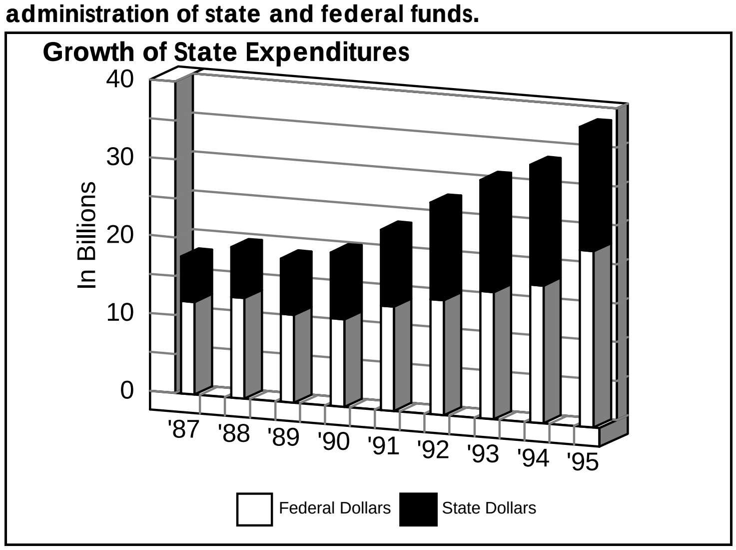
- lack of a self-balancing set of accounts to report General Fund activity which includes assets of $4 billion, revenues in excess of $34 billion, and expenditures and transfers in excess of $36 billion

- extensive manual procedures and lack of timely information which decrease the time available to ensure the financial accuracy of information

Although the material weakness in controls exists, nothing indicated a loss of state funds as a result of this weakness.

The ***Texas Department of Human Services*** has a material weakness in the internal control structure over the *Food Distribution* (CFDA 10.550) program. The Department does not have adequate controls to ensure sufficient documentation to support eligibility determinations for program participation. The *Food Distribution* program provided more than $65 million in U.S. Department of Agriculture commodities to 1,743 recipient agencies in fiscal year 1995.

Figure 1
**A strong control environment helps to ensure proper administration of state and federal funds.**




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

# Executive Summary

## Federal Compliance Helps Reduce Risk

Highlighted below are compliance issues which need to be addressed. Compliance with federal regulations helps reduce the risk of:

- a loss of federal funding
- funds being misspent
- a reduction in services to citizens

### Four Entities Had Instances of Material Noncompliance[3] with Federal Requirements

The ***Texas Department of Protective and Regulatory Services*** is in material noncompliance, for the third consecutive year, with two requirements of the *Child Welfare Services - State Grants* (CDFA 93.645) program. Twenty-nine percent of the expenditure payments tested were unallowable due to insufficient client eligibility documentation. *Child Welfare Services* payments totaled $20.1 million for fiscal year 1995.

The ***General Services Commission*** has made significant progress by resolving eight of the eleven outstanding prior year issues. However, there is material noncompliance with two requirements of the *Donation of Federal Surplus Personal Property* (CFDA 39.003) program. Sixty percent of the donees tested did not have current authorized representative forms. Additionally, the Commission did not monitor for proper use of donated property. The program received approximately $35 million of federal property valued at original acquisition cost.

The ***Texas Department of Housing and Community Affairs*** is in material noncompliance with two federal requirements of the *HOME Investment Partnerships Program* (CFDA 14.239). The Department did not properly monitor program subrecipients and did not ensure compliance with the Davis-Bacon Act. The program provided subrecipients with $12.8 million in federal assistance during the 1995 fiscal year.

The ***State of Texas***, as related to student financial assistance, is in material noncompliance with one specific requirement of the *Federal Family Education Loans* (CFDA 84.032) program. Over 13 percent of financial aid recipients tested did not have enrollment changes reported in accordance with requirements. The *Federal Family Education Loans* program provided over $648 million in aid to Texas students in the 1995 fiscal year.

[3]**Material noncompliance** results when errors found indicate that at least five percent of federal program expenditures or federal assets were not administered properly. (A five percent criteria is a general guideline. Other factors may be considered in making this determination.)

## Summary of Audit Objectives 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 principles

- fulfill audit requirements of the Single Audit Act (Federal Compliance)

- determine compliance with significant bond covenants

- issue individual management letters on reportable conditions[4]

We performed the following procedures:

- 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.

- 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.

- Determined compliance with federal program requirements in accordance with *Office of Management and Budget (OMB) Circular A-128*. We conducted audit work covering 49 federal programs and 91.4 percent of the total federal assistance received during the year.

- Determined compliance with significant bond covenants. We also determined that the information in the supplementary bond schedules is presented fairly.

- Followed up on prior audit issues.

## Summary of Managements' Responses

Management of the agencies and universities mentioned in the "Detailed Findings With Management's Responses" section of this report generally concur with the findings and recommendations. Corrective action plans are included for many of the recommendations.

Copies of the *Texas 1995 Comprehensive Annual Financial Report (CAFR)* may be obtained from the Comptroller of Public Accounts.

Copies of the *1995 Financial and Compliance Audit Results* report may be obtained from the Texas State Auditor's Office.

[4] A **reportable condition** is a deficiency in the design of operation of the internal control structure which would adversely affect the organization's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

# Auditor's Reports

1995 Financial and Compliance Audit Results

SAO Report No. 96-063

May 1996

February 19, 1996

# 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, 1995, and have issued our report thereon dated February 19, 1996. 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 19, 1996.

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 structures at Texas Southern University, the Texas Commission on Alcohol and Drug Abuse, the Comptroller of Public Accounts, and the Texas Department of Human Services

- material noncompliance with federal laws and regulations for certain programs at the Texas Department of Protective and Regulatory Services, the General Services Commission, and the Texas Department of Housing and Community Affairs

- material noncompliance with federal laws and regulations on a statewide level for the *Federal Family Education Loans* program, which is administered by numerous colleges and universities throughout the State

Each of these conclusions is discussed in 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 conditions[1] 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 *1995 Financial and Compliance Audit Results* report dated May 20, 1996. 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, 1995.

## Material Weaknesses Relating to Internal Controls over the General Purpose Financial Statements

Our audit of the Comptroller of Public Accounts disclosed a material weakness relating to internal controls over the State's general purpose financial statements. There is a lack of controls within the Comptroller's current financial reporting process to ensure the accuracy and completeness of the *Comprehensive Annual Financial Report (CAFR)*. This weakness is material to the State of Texas as a whole.

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[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 program

may occur and not be detected by management within a timely period in the normal course of operations.

In addition, during the 1994 financial and compliance audit, we identified a material weakness in the control environment over the Texas Commission on Alcohol and Drug Abuse's fiscal operations. In February 1995, a special task force was developed to investigate allegations of mismanagement and misspending of state and federal funds. The Commission was subsequently placed under conservatorship. Audit work performed by this special task force in fiscal year 1995 indicates the material weakness identified in the 1994 financial and compliance audit continues to exist. Refer to Appendix 3 for additional information regarding the audit results and scope of the special task force audit. Although this weakness is material to the internal control structure of the Commission, it is 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 the following federal financial assistance programs:

- all student financial assistance programs at Texas Southern University, including the *Federal Family Education Loans* program (CFDA 84.032) and *Federal Pell Grant Program* (84.063)

- *Food Distribution* program (CFDA 10.550) at the Texas Department of Human Services

- Federal financial assistance programs administered by the Texas Commission on Alcohol and Drug Abuse, including the *Block Grants for Prevention and Treatment of Substance Abuse* (CFDA 93.959) (See Appendix 3 for additional information).

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

## Material Noncompliance with Federal Laws and Regulations

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

- *Child Welfare Services - State Grants* program (CFDA 93.645) at the Texas Department of Protective and Regulatory Services

- *Donation of Federal Surplus Personal Property* program (CFDA 39.003) at the General Services Commission

- *Federal Family Education Loans* program (CFDA 84.032) administered by numerous colleges and universities throughout the State

The circumstances surrounding these instances of material noncompliance are more fully described in the "Auditor's Report On Compliance" dated February 19, 1996, and in the "Detailed Findings With Management's Responses" section of the *1995 Financial and Compliance Audit Results* report.

Additionally, external auditors identified material noncompliance with federal laws and regulations for the *HOME Investment Partnerships Program* (CFDA 14.239) at the Texas Department of Housing and Community Affairs.

## Other Internal Control Issues

We identified other matters involving the internal control structure and its operation that have been included in the *1995 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, 1995, we considered the State's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinions 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*. This report addresses our consideration of internal control structure policies and procedures relevant to the general purpose financial statements and compliance with requirements applicable to federal financial assistance programs. 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.

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 |
|---|---|
| Employees Retirement System | An audit of its general purpose financial statements was conducted for the year ended August 31, 1995. |

| Entities Reviewed by Other Auditors | Scope of Work Performed |
|---|---|
| Life, Accident, Health and Hospital Service Insurance Guaranty Association | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |
| Permanent School Fund | An audit of the Fund's general purpose financial statements was conducted for the year ended August 31, 1995. |
| Permanent University Fund | An audit of the Fund's Summary of Investments and Summary of Investment Income statements was conducted for the year ended August 31, 1995. |
| Surplus Lines Stamping Office of Texas | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |
| Texas A&M University Development Foundation (Corporation and Trust) | An audit of its general purpose financial statements was conducted for the years ended August 31, 1994, and August 31, 1995. |
| Texas A&M University Research Foundation | An audit was conducted under the provisions of *OMB Circular A-133* for the year ended August 31, 1995. |
| Texas Department of Housing and Community Affairs | An audit was conducted under the provisions of *OMB Circular A-128* for the year ended August 31, 1995. |
| 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 August 31, 1994, and August 31, 1995. |
| Texas Guaranteed Student Loan Corporation | An audit was conducted under the provisions of the *OMB Circular A-133* and regulations issued by the U.S. Department of Education for the years ended September 30, 1994, and September 30, 1995. |
| Texas Local Government Investment Pool | An audit of its general purpose financial statements was conducted for the years ended August 31, 1994, and August 31, 1995. |
| Texas Lottery Commission | An audit of its general purpose financial statements was conducted for the year ended August 31, 1995. |
| Texas Property and Casualty Insurance Guaranty Association | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |
| Texas Title Insurance Guaranty Association | An audit of its general purpose financial statements was conducted for the years ended December 31, 1993, and December 31, 1994. |

| Entities Reviewed by Other Auditors | Scope of Work Performed |
|---|---|
| Texas Turnpike Authority | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |
| Texas Workers' Compensation Insurance Facility | An audit of its general purpose financial statements was conducted for the years ended December 31, 1993, and December 31, 1994. |
| Texas Workers' Compensation Insurance Fund | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |

This report, insofar as it relates to these entities, is based solely on the reports of the other auditors. The management letters for the Teacher Retirement System and the Fire Fighters' Pension Commissioner 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
- Financial reporting
- Inventories
- Payroll/Personnel
- Other

### General Compliance Controls

- Political activity
- Davis-Bacon Act
- Civil rights
- Cash management
- 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 *1995 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, 1995, the State expended 91 percent of its federal financial assistance under major federal financial assistance programs. For the 1995 statewide financial and compliance audit, we used a risk-based approach to determine the level and extent of audit work to be performed for federal programs. This process, in conjunction with auditor judgment, was used to select major federal programs and the state entities where this audit work would be performed. Of the 49 major federal programs, 33 were examined, while the remaining 16 programs were subjected to other audit procedures.

This resulted in 91 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 26 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 the State's major federal financial assistance programs audited.

## Scope for Nonmajor Federal Programs

Because of the large number of nonmajor programs and the decentralized administration of these programs, we examined relevant internal control structure policies and procedures related to nonmajor programs in conjunction with major federal program procedures. The procedures performed on the internal control structure policies and procedures shared by major and nonmajor programs enabled us to obtain assurance over certain nonmajor programs. In addition, we tested the following two nonmajor federal programs for compliance with certain general and specific requirements:

- *Adoption Assistance* program (CFDA 93.659) at the Texas Department of Protective and Regulatory Services
- *Donation of Federal Surplus Personal Property* program (CFDA 39.003) at the General Services Commission

## 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, management, and all federal and other 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

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February 19, 1996

# 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, 1995, and have issued our report thereon dated February 19, 1996. We also audited the State's compliance with significant requirements related to selected major federal financial assistance programs as identified in the "Schedule of Major Federal Programs Examined" section of the *1995 Financial and Compliance Audit Results* report. A listing of all major programs for the State is included in the *Texas 1995 Comprehensive Annual Financial Report (CAFR)* on the Schedule of Federal Financial Assistance.

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 applicable to each of its major federal financial assistance programs that we selected for review

With respect to the items tested, we found:

- material noncompliance with one of 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 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 selected for review:

- types of services allowed or unallowed
- matching, level of effort, and/or earmarking
- amounts claimed or used for matching
- claims for advances and reimbursements
- eligibility
- reporting
- special requirements
- monitoring subrecipients

These programs are identified in the "Schedule of Major Federal Programs Examined" section of the *1995 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 Management's Responses" section of the *1995 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 - State Grants* 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 *Federal Family Education Loans* program (CFDA 84.032), administered by numerous universities throughout the State of Texas, had material noncompliance on a statewide level for reporting of enrollment changes, a special requirement.

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 Management's Responses" sections of the *1995 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 tested for the year ended August 31, 1995.*

## 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 *Texas 1995 Comprehensive Annual Financial Report (CAFR)*, for the year ended August 31, 1995:

- political activity
- civil rights
- federal financial reports
- drug-free workplace
- Davis-Bacon Act
- cash management
- allowable costs/cost principles
- 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.

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

- The *Child Welfare Services - State Grants* program (CFDA 93.645), administered by the Texas Department of Protective and Regulatory Services, had material noncompliance in the area of allowable costs.

We considered this material instance of noncompliance in forming our opinion on whether the State of Texas' 1995 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 19, 1996, on those financial statements.

The results of our 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 Management's Responses" sections of the *1995 Financial and Compliance Audit Results*. In addition, instances of insignificant noncompliance were communicated to the federal grantors separately.

*Except as described above, the results of our procedures to determine compliance with the general compliance requirements indicate that with respect to the items tested, the State of Texas complied in all material respects, 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.*

## 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, 1995.

Because of the large number of nonmajor programs and the decentralized administration of these programs, we examined relevant internal control structure policies and procedures related to nonmajor programs in conjunction with major federal program procedures. The procedures performed on the internal control structure policies and procedures shared by major and nonmajor programs enabled us to obtain assurance for certain nonmajor programs. In addition, we performed auditing procedures to determine compliance with certain general and specific requirements for the following two nonmajor federal programs:

- *Adoption Assistance* program (CFDA 93.659) at the Texas Department of Protective and Regulatory Services was tested for matching and federal financial reporting requirements.

- *Donation of Federal Surplus Personal Property* program (CFDA 39.003) at the General Services Commission was tested for types of services allowed or unallowed, eligibility, special requirements, and administrative requirements.

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 Noncompliance for Nonmajor Federal Programs

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.

Additionally, external auditors identified material noncompliance for the *HOME Investment Partnerships Program* (CFDA 14.239) at the Texas Department of Housing and Community Affairs in the areas of subrecipient monitoring and compliance with the Davis-Bacon Act.

We considered these material instances of noncompliance in forming our opinion on whether the State of Texas' 1995 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 19, 1996, on those financial statements.

The results of our 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 Management's Responses" sections of the *1995 Financial and Compliance Audit Results* report. In addition, instances of insignificant noncompliance were communicated to the federal grantors separately.

*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.*

## 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 the State has complied, in all material respects, with laws, regulations, contracts, and grants applicable to the State of Texas.*

It should be noted, however, that an unauthorized use of state funds occurred in relation to certain purchases made by the Texas State Treasury. The Texas Attorney General issued a legal opinion on February 20, 1996, (Letter Opinion 96-013) concluding that the transactions constituted the withdrawal of funds from the State Treasury without an appropriation, in violation of Article VIII, § 6, of the *Texas*

*Constitution*. The State Treasury attempted to stabilize TexPool, a public funds investment pool for local units of government, by using state funds to purchase TexPool's securities at book value, which was greater than market value. Although the amounts involved are not considered material to the general purpose financial statements, these unauthorized transactions resulted in a loss for the State. The State Auditor's Office examined this issue during a review of the State Treasury's management of TexPool, which is covered in SAO Report No. 96-053.

## Material Weaknesses Relating to Internal Controls

As disclosed in the "Auditor's Report On Internal Controls" dated February 19, 1996, our audit identified material weaknesses in certain elements of the internal control structure at:

- Texas Southern University
- Comptroller of Public Accounts
- Texas Department of Human Services

Additionally, during the 1994 financial and compliance audit, we identified a material weakness in the control environment over the Texas Commission on Alcohol and Drug Abuse fiscal operations and administration of state and federal grants. Audit work performed by a special task force in fiscal year 1995 indicates that this material weakness continues to exist.[1]

## Responsibilities and Methodology

Management at each individual entity is responsible for compliance with the specific requirements listed 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. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We used a risk-based approach to determine the level and extent of audit work to be performed for federal programs during the 1995 statewide financial and compliance audit. This process, in conjunction with auditor judgment, was used to select major federal programs to audit and the state entities where this audit work would be performed.

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[1]Refer to Appendix 3 for additional information regarding the audit results and scope of the special task force audit.

We conducted our audit 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 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.

## Related Reports

In addition to coverage provided by the statewide financial and compliance audit, the State Auditor's Office has performed work specifically related to contract administration. Additional information is provided by this work, which goes beyond the federal compliance requirements covered by the statewide audit. The contract administration reports include various recommendations to improve the State's ability to protect public funds in areas such as fraud, waste, or inefficient use by contractors. Further review by the State Auditor's Office of contract administration is planned or in progress. The agencies and audit report numbers, where applicable, are listed in Appendix 2. Readers of the *1995 Financial and Compliance Audit Results* report may find this information helpful in evaluating an agency's operations.

Additionally, a special task force, comprised of members of the Texas Rangers, the State Auditor's Office, the State Comptroller's Office, and the private accounting firm of Coopers & Lybrand, L.L.P., performed audit work at the Texas Commission on Alcohol and Drug Abuse. The task force was charged with investigating allegations of fiscal mismanagement and illegal activities at the Commission and the individual providers. These investigations provided extensive coverage on contractor, subrecipient, compliance and internal control issues, which we relied upon for the basis of our opinion. A briefing report was released in October 1995 by the Joint Senate and House Investigating Committee, summarizing the preliminary audit findings and recommendations developed by members of the special task force. Additional information on the scope of this audit and the audit results are included in Appendix 3.

## Entities Reviewed by Other Auditors

The State Auditor's Office did not audit the following entities and funds which are component units of the State for financial reporting purposes:

| Entities Reviewed by Other Auditors | Scope of Work Performed |
|---|---|
| Employees Retirement System | An audit of its general purpose financial statements was conducted for the year ended August 31, 1995. |
| Life, Accident, Health and Hospital Service Insurance Guaranty Association | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |
| Permanent School Fund | An audit of the Fund's general purpose financial statements was conducted for the year ended August 31, 1995. |
| Permanent University Fund | An audit of the Fund's Summary of Investments and Summary of Investment Income statements was conducted for the year ended August 31, 1995. |
| Surplus Lines Stamping Office of Texas | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |
| Texas A&M University Development Foundation (Corporation and Trust) | An audit of its general purpose financial statements was conducted for the years ended August 31, 1994, and August 31, 1995. |
| Texas A&M University Research Foundation | An audit was conducted under the provisions of *OMB Circular A-133* for the year ended August 31, 1995. |
| Texas Department of Housing and Community Affairs | An audit was conducted under the provisions of *OMB Circular A-128* for the year ended August 31, 1995. |
| 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 August 31, 1994, and August 31, 1995. |
| Texas Guaranteed Student Loan Corporation | An audit was conducted under the provisions of the *OMB Circular A-133* and regulations issued by the U.S. Department of Education for the years ended September 30, 1994, and September 30, 1995. |
| Texas Local Government Investment Pool | An audit of its general purpose financial statements was conducted for the years ended August 31, 1994, and August 31, 1995. |
| Texas Lottery Commission | An audit of its general purpose financial statements was conducted for the year ended August 31, 1995. |
| Texas Property and Casualty Insurance Guaranty Association | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |

| Entities Reviewed by Other Auditors | Scope of Work Performed |
|---|---|
| Texas Title Insurance Guaranty Association | An audit of its general purpose financial statements was conducted for the years ended December 31, 1993, and December 31, 1994. |
| Texas Turnpike Authority | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |
| Texas Workers' Compensation Insurance Facility | An audit of its general purpose financial statements was conducted for the years ended December 31, 1993, and December 31, 1994. |
| Texas Workers' Compensation Insurance Fund | An audit of its general purpose financial statements was conducted for the year ended December 31, 1994. |

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. Management letters for 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 federal and other 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

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# Our Compliments to 28 Agencies

1995 Financial and Compliance Audit Results

SAO Report No. 96-063

May 1996

# Our Compliments to 28 Agencies

We are pleased to report that 28 of the 45 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.

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 |
| Commerce, Texas Department of | Federal and Bonds |
| Criminal Justice, Texas Department of | Bonds |
| East Texas State University | Bonds |
| Employment Commission, Texas | Federal |
| General Land Office and Veteran's Land Board | Financial and Bonds |
| Hospital Equipment Financing Council, Texas | Bonds |
| Insurance, Texas Department of | Financial |
| Lamar University - Orange | Bonds |
| Lamar University - Port Arthur | Bonds |
| Midwestern State University | Bonds |
| National Research Laboratory Commission, Texas | Bonds |
| Public Finance Authority, Texas | Financial and Bonds |
| Rehabilitation Commission, Texas | Federal |
| Stephen F. Austin State University | Bonds |
| Texas State University System:<br>System Office<br>Sam Houston State University<br>Southwest Texas State University<br>Sul Ross State University | Bonds |
| Texas Tech University | Bonds |
| Texas Tech University Health Sciences Center | Bonds |
| University of North Texas Health Science Center | Bonds |

| Agency | Type of Work Performed |
|---|---|
| The University of Houston System | Bonds |
| The University of Texas System:<br>System Administration<br>Health Science Center at Houston | <br>Bonds<br>Federal |
| Water Development Board, Texas | Financial and Bonds |
| Woman's University, Texas | Bonds |

# Summary of Issues

1995 Financial and Compliance Audit Results

SAO Report No. 96-063

May 1996

# 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

***FFELP Loan Proceeds*** — This refers to issues arising from receipt of loan proceeds granted by the *Federal Family Education Loans* (CFDA 84.032) program and subsequently disbursed by student financial assistance offices.

***EDP Issues*** — Electronic data processing (EDP) controls are intended to minimize the risk of unauthorized access, modification, and/or damage to computer equipment, electronic data processing programs, and data. The specific issues identified in this category pertain to controls over data entry, data processing, and data security.

***Control Environment*** — The control environment reflects the overall attitude, awareness, and actions of the board, management, and others concerning the importance of and emphasis on controls within the organization.

***Other Internal Controls*** — Other issues were identified in the areas of timely and effective reconciliations, controls over inventory, and effective monitoring by internal audit.

## Compliance

***Bond Compliance*** — Contractual promises within bond resolutions, known as covenants, set forth repayment schedules of principal and interest and other restrictions to protect the bondholders' investments. The issue within this category is related to ensuring sufficient revenues are available in order to meet future debt service requirements.

***Federal Compliance*** — 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.

***State Compliance*** — Entities must also comply with State laws and regulations. The accrual of interest on delinquent child support, and use of an approved, standardized student budget for financial aid determinations are State compliance issues.

## Accounting and Reporting

***Accounting and Reporting***

Accounting and reporting includes issues that could impact the accuracy and completeness of the financial statements such as: promoting adherence to generally accepted accounting principles, ensuring the accuracy of financial reports, and ensuring timely correction of reconciling items and adjustments within the accounting records.

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# Summary Listing of All Issues by Agency and University

| Agency | Page | Agency No. | SAO Report No. | INTERNAL CONTROLS: FFELP Loan Proceeds | EDP Issues | Control Environment | Other |
|---|---|---|---|---|---|---|---|
| Aging, Texas Department on | 43 | 340 | 96-044 | | 1 | | |
| Attorney General, Office of the | 52 | 302 | 96-301 | | | | |
| Comptroller of Public Accounts | 56 | 304 | 96-337 | | | | |
| Education Agency, Texas | 68 | 701 | 96-309 | | 1 | | 1 |
| General Services Commission | 74 | 303 | 96-300 | | | | 1 |
| Health, Texas Department of | 80 | 501 | 96-327 | | | | |
| Higher Education Coordinating Board, Texas | 86 | 781 | 96-040 | | | | |
| Human Services, Texas Department of | 88 | 324 | 96-324 | | | | 2 |
| Lamar University System: Lamar - Beaumont | 98 | 734 | 96-328 | | | | |
| Protective and Regulatory Services, Texas Department of | 100 | 530 | 96-318 | | | | |
| Texas A&M University System: Texas A&M | 108 | 711 | 96-039 | | | | |
| Texas Southern University | 113 | 717 | 96-042 | 1 | | 1 | |
| Texas State Technical College - Waco | 130 | 719 | 96-035 | 1 | | | |
| Texas State Treasury Department | 138 | 310 | 96-325 | | | | 1 |
| Texas State University System: Angelo State | 48 | 737 | 96-038 | | | | |
| Transportation, Texas Department of | 134 | 601 | 96-311 | | 1 | 1 | |
| University of Texas System: UT M.D. Anderson | 147 | 506 | 96-307 | | | | |
| University of North Texas | 140 | 752 | 96-041 | 1 | | | |
| **TOTAL** | | | | **3** | **3** | **2** | **5** |

# Summary Listing of All Issues by Agency and University

| Agency | Page | Agency No. | SAO Report No. | COMPLIANCE Bonds | COMPLIANCE Federal | COMPLIANCE State | Accounting and Reporting | Totals |
|---|---|---|---|---|---|---|---|---|
| Aging, Texas Department on | 43 | 340 | 96-044 | | | | | 1 |
| Attorney General, Office of the | 52 | 302 | 96-301 | | 1 | 1 | | 2 |
| Comptroller of Public Accounts | 56 | 304 | 96-337 | | 1 | | 3 | 4 |
| Education Agency, Texas | 68 | 701 | 96-309 | | 1 | | 1 | 4 |
| General Services Commission | 74 | 303 | 96-300 | | 2 | | | 3 |
| Health, Texas Department of | 80 | 501 | 96-327 | | 2 | | | 2 |
| Higher Education Coordinating Board, Texas | 86 | 781 | 96-040 | | 1 | | | 1 |
| Human Services, Texas Department of | 88 | 324 | 96-324 | | 5 | | | 7 |
| Lamar University System: Lamar - Beaumont | 98 | 734 | 96-328 | 1 | | | | 1 |
| Protective and Regulatory Services, Texas Department of | 100 | 530 | 96-318 | | 5 | | 2 | 7 |
| Texas A&M University System: Texas A&M | 108 | 711 | 96-039 | | 4 | | | 4 |
| Texas Southern University | 113 | 717 | 96-042 | | 11 | 1 | | 14 |
| Texas State Technical College - Waco | 130 | 719 | 96-035 | | 2 | | | 3 |
| Texas State Treasury Department | 138 | 310 | 96-325 | | | | | 1 |
| Texas State University System: Angelo State | 48 | 737 | 96-038 | | 3 | | | 3 |
| Transportation, Texas Department of | 134 | 601 | 96-311 | | 1 | | | 3 |
| University of Texas System: UT M.D. Anderson | 147 | 506 | 96-307 | | 1 | | | 1 |
| University of North Texas | 140 | 752 | 96-041 | | 6 | | | 7 |
| **TOTAL** | | | | **1** | **46** | **2** | **6** | **68** |

# Federal Issues by Agency and University

| Agency | Page | Agency No. | SAO Report No. | GENERAL PROGRAM REQUIREMENTS: Allowable Costs/Cost Principles | Cash Management | Other |
|---|---|---|---|---|---|---|
| Attorney General, Office of the | 52 | 302 | 96-301 | | | |
| Comptroller of Public Accounts | 56 | 304 | 96-337 | | 1 | |
| Education Agency, Texas | 68 | 701 | 96-309 | | 1 | |
| General Services Commission | 74 | 303 | 96-300 | | | |
| Health, Texas Department of | 80 | 501 | 96-327 | | 1 | 1 |
| Higher Education Coordinating Board, Texas | 86 | 781 | 96-040 | | | |
| Human Services, Texas Department of | 88 | 324 | 96-324 | 2 | 1 | |
| Protective and Regulatory Services, Texas Department of | 100 | 530 | 96-318 | 2 | | 1 |
| Texas A&M University System: Texas A&M | 108 | 711 | 96-039 | | | |
| Texas Southern University | 113 | 717 | 96-042 | | | |
| Texas State Technical College - Waco | 130 | 719 | 96-035 | | | |
| Texas State University System: Angelo State | 48 | 737 | 96-038 | | | |
| Transportation, Texas Department of | 134 | 601 | 96-311 | | | |
| University of Texas System: UT M.D. Anderson | 147 | 506 | 96-307 | 1 | | |
| University of North Texas | 140 | 752 | 96-041 | | | |
| **TOTAL** | | | | **5** | **4** | **2** |

# Federal Issues by Agency and University

| Agency | Page | Agency No. | SAO Report No. | SPECIFIC COMPLIANCE: Subrecipient Monitoring | Student Financial Aid | Other | Totals |
|---|---|---|---|---|---|---|---|
| Attorney General, Office of the | 52 | 302 | 96-301 | | | 1 | 1 |
| Comptroller of Public Accounts | 56 | 304 | 96-337 | | | | 1 |
| Education Agency, Texas | 68 | 701 | 96-309 | | | | 1 |
| General Services Commission | 74 | 303 | 96-300 | | | 2 | 2 |
| Health, Texas Department of | 80 | 501 | 96-327 | | | | 2 |
| Higher Education Coordinating Board, Texas | 86 | 781 | 96-040 | | 1 | | 1 |
| Human Services, Texas Department of | 88 | 324 | 96-324 | 2 | | | 5 |
| Protective and Regulatory Services, Texas Department of | 100 | 530 | 96-318 | | | 2 | 5 |
| Texas A&M University System: TX A&M | 108 | 711 | 96-039 | | 4 | | 4 |
| Texas Southern University | 113 | 717 | 96-042 | | 11 | | 11 |
| Texas State Technical College - Waco | 130 | 719 | 96-035 | | 2 | | 2 |
| Texas State University System: Angelo State | 48 | 737 | 96-038 | | 3 | | 3 |
| Transportation, Texas Department of | 134 | 601 | 96-311 | | | 1 | 1 |
| University of Texas System: UT M.D. Anderson | 147 | 506 | 96-307 | | | | 1 |
| University of North Texas | 140 | 752 | 96-041 | | 6 | | 6 |
| **TOTAL** | | | | **2** | **27** | **6** | **46** |

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# Federal Schedules

1995 Financial and Compliance Audit Results

SAO Report No. 96-063

May 1996

## Schedule 1:
# Schedule of Major Federal Programs Examined for the Year Ended August 31, 1995

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. Federal Programs examined were identified on a risk basis.

| CFDA | Schedule of Major Federal Programs Examined<br>Program Title | State Agency or University | Expenditures (in millions) | Percentage of State's Total Federal Expenditures |
|---|---|---|---|---|
| 10.550 | *Food Distribution* | Human Services,<br>Texas Department of | $ 61.6 | 0.39 |
| 10.551 | *Food Stamps* | Human Services,<br>Texas Department of | 2,239.5 | 14.14 |
| 10.553 | *School Breakfast Program* | Education Agency, Texas | 114.0 | 0.72 |
| 10.555 | *National School Lunch Program* | Education Agency, Texas | 421.9 | 2.66 |
| 10.557 | *Special Supplemental Nutrition Program for Women, Infants, and Children* | Health,<br>Texas Department of | 256.6 | 1.62 |
| 10.561 | *State Administrative Matching Grants for Food Stamp Program* | Human Services,<br>Texas Department of | 141.6 | 0.89 |
| 17.225 | *Unemployment Insurance* | Employment Commission,<br>Texas | 158.9 | 1.00 |
| 17.246 | *Employment and Training Assistance - Dislocated Workers* | Commerce,<br>Texas Department of | 56.6 | 0.36 |
| 17.250 | *Job Training Partnership Act* | Commerce,<br>Texas Department of | 160.7 | 1.01 |
| 20.205 | *Highway Planning and Construction* | Transportation,<br>Texas Department of | 966.2 | 6.10 |
| 84.032 | *Federal Family Education Loans (FFELP)* | - Angelo State University<br>- Coordinating Board, Texas Higher Education<br>- North Texas, University of<br>- Texas A&M University<br>- Texas Southern University<br>- Texas State Technical College - Waco | 9.1<br>26.4<br>37.9<br>57.7<br>31.9<br>6.3 | 0.06<br>0.17<br>0.24<br>0.36<br>0.20<br>0.04 |

**Schedule of Major Federal Programs Examined**

| CFDA | Program Title | State Agency or University | Expenditures (in millions) | Percentage of State's Total Federal Expenditures |
|---|---|---|---|---|
| 84.063 | *Federal Pell Grant Program* | - Angelo State University<br>- North Texas, University of<br>- Texas A&M University<br>- Texas Southern University<br>- Texas State Technical College - Waco | 2.6<br>5.1<br>8.4<br>9.6<br>2.8 | 0.02<br>0.03<br>0.05<br>0.06<br>0.02 |
| 84.126 | *Rehabilitation Services - Vocational Rehabilitation Grants to States* | Rehabilitation Commission, Texas | 107.8 | 0.68 |
| 84.173 | *Special Education - Preschool Grants* | Education Agency, Texas | 22.3 | 0.14 |
| 93.045 | *Special Programs for the Aging - Title III, Part C - Nutrition Services* | Aging, Texas Department on | 21.9 | 0.14 |
| 93.395 | *Cancer Treatment Research* | The University of Texas M.D. Anderson Cancer Center | 14.8 | 0.09 |
| 93.560 | *Family Support Payments to States - Assistance Payments* | Human Services, Texas Department of | 389.7 | 2.46 |
| 93.561 | *Job Opportunities and Basic Skills Training* | Human Services, Texas Department of | 38.7 | 0.24 |
| 93.563 | *Child Support Enforcement* | Attorney General, Office of the | 103.2 | 0.65 |
| 93.565 | *State Legalization Impact Assistance Grants* | Health, Texas Department of | 21.1 | 0.13 |
| 93.575 | *Child Care and Development Block Grant* | Human Services, Texas Department of | 89.8 | 0.57 |
| 93.645 | *Child Welfare Services - State Grants* | Protective and Regulatory Services, Texas Department of | 20.1 | 0.13 |
| 93.658 | *Foster Care - Title IV-E* | Protective and Regulatory Services, Texas Department of | 107.5 | 0.68 |
| 93.667 | *Social Services Block Grant* | Human Services, Texas Department of | 96.3 | 0.61 |
| 93.777 | *State Survey and Certification of Health Care Providers and Suppliers* | Human Services, Texas Department of | 26.4 | 0.17 |
| 93.778 | *Medical Assistance Program (Medicaid)* | - Health, Texas Department of<br>- Human Services, Texas Department of | 4,159.3<br>1,554.3 | 26.28<br>9.84 |

| CFDA | Schedule of Major Federal Programs Examined — Program Title | State Agency or University | Expenditures (in millions) | Percentage of State's Total Federal Expenditures |
|---|---|---|---|---|
| 93.837 | *Heart and Vascular Disease Research* | University of Texas Health Science Center - Houston | 15.1 | 0.10 |
| 93.959 | *Block Grant for Prevention and Treatment of Substance Abuse* | Alcohol and Drug Abuse, Texas Commission | 84.2 | 0.53 |
| 93.994 | *Maternal and Child Health Services Block Grant to the States* | Health, Texas Department of | 38.1 | 0.24 |
| 96.001 | *Social Security - Disability Insurance* | Rehabilitation Commission, Texas | 74.8 | 0.47 |
| Subtotal: Major Federal Programs Examined | | | $11,760.8 | 74.27 |
| Other Major Program Expenditures Covered by SAO Audit Procedures | | | 2,564.7 | 16.20 |
| Major Federal Programs Audited by External Entities | | | 148.4 | 0.94 |
| **Total Major Federal Programs Examined** | | | **$14,473.9** | **91.41** |

## Schedule 2:
# Schedule of Findings and Questioned Costs by Federal Agency for the Year Ended August 31, 1995

*Office of Management and Budget (OMB) Circular A-128* requires the reporting of all instances of noncompliance and questioned costs. This schedule includes a detailed listing of all significant costs questioned as a result of the fiscal year 1995 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 grantor separately.

The questioned costs are organized by federal granting agency and are listed by the affected state agency or university. The findings in this schedule, identified with a *Catalog of Federal Domestic Assistance (CFDA)* number, are also included in the "Detailed Findings with Management's 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 | | |
| *Child and Adult Care Food Program* (CFDA 10.558) | Program subrecipients did not submit audit reports as required by federal regulations. | $ 3,210,533 |
| *Summer Food Service Program for Children* (CFDA 10.559) | Disbursements of federal funds were made for unallowable expenditures. | 25 |
| *State Administrative Expenses for Child Nutrition* (CFDA 10.560) | | 633 |
| *State Administrative Matching Grants for Food Stamp Program* (CFDA 10.561) | | 62,453 |
| **Total U.S. Department of Agriculture** | | **$ 3,273,644** |
| **U.S. DEPARTMENT OF EDUCATION** | | |
| A. Texas Southern University | | |
| *Federal Supplemental Educational Opportunity Grants* (CFDA 84.007) | Relates to disbursements made to ineligible students due to missing financial aid transcripts. | $ 2,500 |

**Schedule of Findings and Questioned Costs by Federal Agency**

| Program | Finding/Noncompliance | Questioned Costs |
|---|---|---|
| *Federal Family Education Loans* (CFDA 84.032) | Relates to disbursements made in excess of need and disbursements made to ineligible students due to insufficient academic progress, incomplete student aid reports, missing financial aid transcripts, and a missing student file. | 158,342 |
| *Federal Work-Study Program* (CFDA 84.033) | Relates to disbursements made to ineligible students due to insufficient academic progress and missing financial aid transcripts. | 4,820 |
| *Federal Pell Grant Program* (CFDA 84.063) | Relates to disbursements made to ineligible students due to insufficient academic progress, incomplete student aid reports, missing financial aid transcripts, and a missing student file. | 39,199 |
| B. University of North Texas | | |
| *Federal Family Education Loans* (CFDA 84.032) | Procedures do not ensure that financial aid is not in excess of need for students who also receive non-federal aid. | $ 3,812 |
| **Total Department of Education** | | **$ 208,673** |
| | **FEDERAL HIGHWAY ADMINISTRATION** | |
| A. Texas Department of Transportation | | |
| *Highway Planning and Construction* (CFDA 20.205) | Source documents were not retained to validate payments to the contractor. | $ 12,820 |
| **Total Federal Highway Administration** | | **$ 12,820** |
| | **GENERAL SERVICES ADMINISTRATION** | |
| A. General Services Commission | | |
| *Donation of Federal Surplus Personal Property* (CFDA 39.003) | Use of donated property was not monitored in accordance with compliance requirements. | $ 10,680 |
| *Donation of Federal Surplus Personal Property* (CFDA 39.003) | Not all goods received were counted upon receipt. | 1,514 |
| **Total General Services Administration** | | **$ 12,194** |
| | **DEPARTMENT OF HEALTH AND HUMAN SERVICES** | |
| A. Texas Department of Human Services | | |
| *Family Preservation and Support Services* (CFDA 93.556) | Disbursements of federal funds were made for unallowable expenditures. | $ 500 |

| Schedule of Findings and Questioned Costs by Federal Agency | | |
|---|---|---|
| **Program** | **Finding/Noncompliance** | **Questioned Costs** |
| *Family Support Payments to States - Assistance Payments* (CFDA 93.560) | Disbursements of federal funds were made for unallowable expenditures. (continued) | 22,580 |
| *Job Opportunities and Basic Skills Training* (CFDA 93.561) | | 3,295 |
| *Refugee and Entrant Assistance - State Administered Programs* (CFDA 93.566) | | 79 |
| *Child Care for Families At-Risk of Welfare Dependency* (CFDA 93.574) | | 51 |
| *Child Care and Development Block Grant* (CFDA 93.575) | | 5,575 |
| *Child Welfare Services - State Grants* (CFDA 93.645) | | 13 |
| *Foster Care - Title IV-E* (CFDA 93.658) | | 529 |
| *Adoption Assistance* (CFDA 93.659) | | 220 |
| *Social Services Block Grant* (CFDA 93.667) | | 320 |
| *State Survey and Certification of Health Care Providers and Suppliers* (CFDA 93.777) | | 5,391 |
| *Medical Assistance Program* (CFDA 93.778) | | 63,985 |
| B. Texas Department of Protective and Regulatory Services | | |
| *Child Welfare Services - State Grants* (CFDA 93.645) | Adequate documentation was not maintained to support program eligibility and allowable costs. | $ 7,504 |
| *Foster Care - Title IV-E* (CFDA 93.658) | Costs charged were not allowable under program guidelines. | 2,900,000 |
| *Family Support Payments to States - Assistance Payments* (CFDA 93.560) | Disbursements of federal funds were made for unallowable expenditures. | 36,143 |
| *Foster Care-Title IV-E* (CFDA 93.658) | | 7,990 |

**Schedule of Findings and Questioned Costs by Federal Agency**

| Program | Finding/Noncompliance | Questioned Costs |
|---|---|---|
| *Adoption Assistance* (CFDA 93.659) | Disbursements of federal funds were made for unallowable expenditures. (continued) | 3,915 |
| *Social Services Block Grant* (CFDA 93.667) | | 51,660 |
| *Medical Assistance Program* (CFDA 93.778) | | 49,634 |
| C. The University of Texas M.D. Anderson Cancer Center | | |
| *Cancer Treatment Research* (CFDA 93.395) | Purchase payment discounts were not allocated back to federal grants. | $ 9,826 |
| **Total Department of Health and Human Services** | | **$ 3,169,210** |
| **TOTAL QUESTIONED COSTS - ALL AGENCIES** | | **$ 6,676,541** |

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# Detailed Findings
# with Managements' Responses

1995 Financial and Compliance Audit Results

SAO Report No. 96-063

May 1996

## Overall Conclusion

The Texas Department on Aging (Department) is generally complying with the federal regulations for the *Title III, Part C - Nutrition Services* program ($21.9 million). However, the Department should improve controls over its Client Information System.

We are pleased to report that management has successfully addressed the material weakness in the control environment over the Department's accounting function.

## Other Related Reports

The State Auditor's Report on *Management Controls at the Texas Department on Aging*, SAO Report No. 96-030, December 1995, reported two internal control weaknesses which impacted the Texas Department on Aging's major federal program, *Special Programs for the Aging - Title III, Part C - Nutrition Services* (CFDA 93.045). Management has taken corrective action to strengthen controls for one of the weaknesses related to achievement reviews of Area Agencies on Aging (AAA). Corrective action efforts are in progress for strengthening controls over data processing. Because the second issue remains unresolved, it is repeated in this report.

## Internal Control Issue

INTERNAL CONTROL ISSUE 1:

### Enhance Department Information System Controls

**The Texas Department on Aging (Department) has not designed controls to compensate for the increased opportunities for data errors in its Client Information System (System)**. Current controls over data processing do not provide reasonable assurance that data is correctly entered, properly processed, and fairly reported. Additional processing controls, improved documentation of data entry standards and procedures, and increased user support would improve data processing and better ensure the integrity of data.

The Client Information System is used to collect data on services provided by 300-plus service providers and 28 AAAs. Information in the System is used to meet federal and state reporting requirements. The Department recognizes the importance of accurate client information, but current policies and procedures do not ensure consistent and accurate information processing:

- System data is not maintained and managed in one central location.

- Access to System data on the provider and AAA stand-alone computers is not always restricted.

- Computer expertise of System users varies at provider and AAA levels.

- Training and communication from Department to System users has been technical and not tailored to varying levels of provider/AAA expertise and equipment.

- Computer hardware varies across the network.

- Currently, each AAA and provider is responsible for selecting and configuring its own computer hardware.

- Except for a recently added edit, the current version of the System software does not have adequate editing routines to provide automated controls over the accuracy and completeness of data.

- The System User Guide does not document policies and procedures to ensure the integrity of data. Additionally, the Guide does not define backup retention and storage standards or procedures for software virus protection.

- The Department has not documented policies against changing or tailoring System software codes by network users.

<u>Recommendation</u>:

The Texas Department on Aging should update its Client Information System User Guide by incorporating standards and policies for the following:

- generation of supporting documents for data entry
- mandatory data entry verification prior to final posting
- backup retention and storage of data files
- virus protection procedures
- System software changes

The Department could also establish controls to compensate for the nature of its "distributed" system by:

- communicating the importance of System data and report requirements to users
- providing operational System training in a "hands-on" environment
- assessing the level of computer expertise of System users for use in planning
- ensuring that recommended computer hardware is configured properly
- maintaining an inventory of the computer hardware at use in the network

Additional work is needed to ensure that the sporadic data errors reported by AAAs are not caused by the System during the loading, compiling, transmitting, and down-loading processes. The Department should consider conducting a comprehensive application audit to formally evaluate critical areas such as security access and data edits.

Management's Response:

*We agree with the recommendations. Activities are underway to achieve the recommendations by January 31, 1996. The specific recommendations require some discussion as follows:*

***Regarding user guide modifications:*** *The Data Services Division will make modifications to the user guide to enhance the user's ability to work with the system. These modifications will include:*

- *An Appendix on Maintenance to the Guide to include:*
  - *Backup retention and storage standards*
  - *Procedures for virus protection*
  - *Standards for restricting access to data and programs*
  - *Restrictions on the use of the system's data files*
  - *The need for end-user commitment to ensuring valid data*
  - *Prohibitions against the modification of the system*

  *Modifications to the information system software are not possible without access to its source code. The Data Services Division has not shared the source code with network users. All required modifications to the software are completed by Data Services staff.*

- *An Additional Chapter to include:*
  - *Procedures to use in verifying data integrity. These will include how to check data entry before final posting and how to use the data verification report, the client statement of services, the services report, and program performance reports to verify information prior to submitting data to the AAA.*
  - *The area agency software manual will also be modified to include a chapter on data review prior to submission to the Department.*

***Regarding controls related to the distributed nature of the system:*** *The Data Services staff provides technical assistance to the AAAs staff in the operation and maintenance of the Department's software. The Department staff also provides technical assistance to service provider staff as needed, especially if the area agency staff is not able to* *effectively address the technical problem. Every problem that is presented to the Department's technical staff is addressed.*

*With the exception of the 1995 regional training series, the Department has always provided "hands-on" end-user software training. In the future, the end-user training will be "hands-on" and will take into consideration the computer expertise of the end-user.*

*The Data Services Division has always encouraged the acquisition of up-to-date computer equipment as an investment in the proper tools to get the job done. AAAs are required to submit proposed computer acquisitions to the Department for approval. Along with approving the acquisition, the data services staff also provide technical advice on alternatives to help ensure that the agency will receive the most return for its expenditure. Service providers are required to submit proposed computer acquisitions to the area agencies for approval. Data Services has been approving these acquisitions for years and the equipment has always been compatible and able to run the Department's software.*

*The CIS User's Guide includes in Appendix A Installation the recommended system required to run this software. In the past, services providers have been reluctant to pull funds away from services to purchase computer equipment. If the provider is able, it will acquire state-of-the-art equipment. If not, it will usually inherit the "hand-me-downs" from the AAA or other source.*

*In July 1994, the Department conducted a survey of the AAAs to collect information about the agencies' computer hardware and software. An updated survey was conducted in November, 1995. The Department will consider this information when developing and presenting end-user training.*

***Regarding editing controls:*** *While we agree additional edit checks should be included in the software, there are many validity checks included in the client intake data entry, such as the user cannot delete a client who has received at least one service unit, as well as others not listed here.*

*To help verify data entered into the monthly service information system, Data Services will soon add a way for the user to compare what he or she entered against what appears in the input document. The Data Services Division is also reviewing the system for the purpose of adding error trapping (edits) to further validate data entry wherever. Finally, we have a users' group known as the Budget and Reporting Workgroup to assist in identifying additional edits and routines.*

## Audit Scope

The primary focus of our audit was the Department's administrative controls over the major federal program, *Special Programs for the Aging - Title III, Part C - Nutrition Services* program, totaling $21.9 million. We gained an understanding of the general control environment, tested controls related to the federal program, and followed up on prior year findings. We also performed procedures to test for compliance with significant federal program requirements.

## Overall Conclusion

Angelo State University (University) has established a system that ensured compliance with significant bond covenants during fiscal year 1995. The bond schedules and bond-related "Notes to the Financial Statements" in the University's *1995 Annual Financial Report* are materially correct and in conformity with the Comptroller's reporting requirements for annual financial reports. At August 31, 1995, Angelo State University reported three outstanding bond issues, totaling $7 million.

The University is generally complying with federal regulations regarding the *Federal Family Education Loans* ($9.1 million) and the *Federal Pell Grant* ($2.6 million) student financial assistance programs. However, areas needing improvement include separating the duties of processing and receiving loan checks, and ensuring that borrowers are informed of their rights and responsibilities. In addition, the University should implement procedures to ensure that all enrollment changes are reported to the guarantor or lender.

## Federal Compliance Issues

FEDERAL COMPLIANCE ISSUE 1:

### Strengthen Controls over Receipt and Disbursement of Loan Proceeds

**The University's Student Financial Assistance (SFA) Office should strengthen controls over receipt and disbursement of loan proceeds from the lenders of the *Federal Family Education Loans* program (CFDA 84.032).** The SFA Office is currently receiving and disbursing loan proceeds, as well as processing the loan applications. This increases the risk that SFA personnel could process unauthorized loans and retain the loan proceeds without being detected.

*Title 34 of the Code of Federal Regulations (CFR), § 668.16(c)*, requires an institution to ensure that its procedures for administering the student financial aid programs include an adequate system of internal checks and balances. The regulations further state that an institution is to divide the functions of authorizing payments and disbursing or delivering funds so that no one office has responsibility for both functions.

Recommendation:

We recommend that the University strengthen internal controls over the receipt and disbursement of loan checks. This can be accomplished by requiring loan checks to be received from the lenders and disbursed to the students by the Bursar's Office.

*Management's Response*:

*Angelo State University will require all loan checks received from lenders to be sent directly to the Fiscal office for disbursement to students. Procedures for this process will be implemented during the fall 1995 semester.*

FEDERAL COMPLIANCE ISSUE 2:

## Conduct Entrance Counseling in Person or by Videotape

**The Student Financial Assistance Office is not conducting entrance counseling in person or by videotape for recipients of the *Federal Family Education Loans* program (CFDA 84.032).** Current procedures require each student to read and sign an entrance counseling form when receiving his or her loan check. However, this does not ensure that the student has read or understood the information. This provides a greater probability that students will not be informed of their rights and responsibilities, which could result in higher loan default rates.

*Title 34 of the Code of Federal Regulations (CFR), § 682.604(f),* requires a school to conduct counseling with each Stafford borrower either in person or by videotape presentation. In conducting the counseling, the school must emphasize the importance of the repayment obligation, describe the likely consequences of default, and emphasize that the borrower is expected to pay the full amount of the loan even if the borrower does not complete the program.

Recommendation:

We recommend the Student Financial Assistance Office conduct entrance counseling sessions in person or by videotape to ensure that borrowers are informed of their rights and responsibilities.

*Management's Response*:

*The Student Financial Aid Office will conduct formal entrance counseling sessions by use of video tape either individually or in group sessions. Procedures and guidelines will be developed during the fall 1995 semester with complete implementation by January 1996.*

FEDERAL COMPLIANCE ISSUE 3:

## Report All Enrollment Changes to the Guarantor or Lender

**The University is not reporting all enrollment changes for the *Federal Family Education Loans* program (CFDA 84.032) to the guarantor or lender.** Enrollment changes occur when a student graduates, withdraws, drops classes, or is expelled. For 7 of the 25 files tested (28 percent), the students' enrollment changes were not reported. These exceptions occurred because current procedures are not adequate to identify those students who are enrolled on a full-time basis, but later drop below full-time. Not reporting enrollment changes may result in delayed loan repayment to lenders.

*Title 34 of the Code of Federal Regulations (CFR), § 682.610,* requires an institution to notify the guarantor if it discovers that a loan has been made to or on behalf of a full-time student who has ceased to be enrolled on a full-time basis. If the institution does not expect to report enrollment changes on the next student status confirmation report within 60 days, it is required to notify either the guarantor or the lender by letter within 30 days.

Recommendation:

We recommend the University report all enrollment changes to the guarantor or lender. The University should develop procedures to identify those students who drop below full-time status during a semester.

*Management's Response*:

*The Registrar's Office is in the final stages of completing electronic enrollment verification with the student loan clearinghouse which should be operational by January 1996. This will allow us to report enrollment changes on a monthly basis (every 30 days). In the interim, the Financial Aid Office has developed a program to identify all loan recipients who have changed enrollment status from full-time to less than full-time so they may be reported in a timely manner.*

# Audit Scope

## Bonds

The primary focus of our audit was on the University's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. At August 31, 1995, Angelo State University reported three outstanding bond issues, totaling $7 million.

We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines.

## Federal Compliance

The primary focus of our audit was on the University's two largest student financial assistance programs: the *Federal Family Education Loans* 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. For fiscal year 1995, the total dollar values of the programs at the University are as follows:

| | |
|---|---|
| *Federal Pell Grant Program* | $2,654,059 |
| *Federal Family Education Loans* program | $9,126,886 |

## Overall Conclusion

The Office of the Attorney General (Office) is in compliance with most federal regulations related to the *Child Support Enforcement* program. However, errors were noted in the calculation of past due child support (arrearage) balances. Additionally, interest, which is required by state law, is not included in the arrearage balances.

Prior year control weaknesses involving the child support collection/distribution functions and cash reconciliation processes have been resolved. We commend the Office for the corrective action taken to address these weaknesses.

The Office collected and distributed approximately $491 million in child support payments during fiscal year 1995 and received $103 million to administer the program. There are over 700,000 child support cases handled through the *Child Support Enforcement* program. Approximately 360,000 cases have court ordered support which must be monitored for arrearage balances.

## Federal Compliance Issue

FEDERAL COMPLIANCE ISSUE 1:

### Ensure Accuracy of Child Support Arrearage Balances

(Prior Audit Issue)

**The Office of the Attorney General does not maintain accurate child support arrearage balances on the Child Support Enforcement automated system**. Arrearage balances represent past due child support. Accuracy is essential to ensure collecting the full amount due, if possible, and to prevent over-collection. Additionally, correct arrearage balances help ensure proper distribution of child support payments.

Of the 25 child support cases tested, 7 had incorrect arrearage balances, resulting in a 28 percent error rate. This error rate is consistent with errors noted during the past five audits (since 1991).

There are over 700,000 child support cases handled through the *Child Support Enforcement* program (CFDA 93.563). Approximately 360,000 cases have court ordered support which must be monitored for arrearage balances.

Data entry errors and misinterpretation of support order information contribute to the inaccuracy of arrearage balances. Arrearage balances are being recalculated and corrected for the system being developed. However, these corrections are not consistently being made on the system currently in use.

Recommendation:

We recommend the Office ensure the accuracy of the arrearage balances on the current Child Support Enforcement System. Procedures should be developed to review case file data when it is entered, modified, or deleted in order to minimize errors. Additionally, the Office should correct balances on the current system as errors are noted during the new system conversion process.

*Management's Response*:

*This office concurs with the auditor's recommendations. The Child Support Division has implemented corrective actions to improve the accuracy of the arrearage balances. The positive impact of these measures are reflected in the reduction of the arrearage errors from the previous year's Audit Report.*

*To continue this downward trend and thus further minimize errors, additional efforts are being implemented:*

- *To improve arrearage information integrity in the current system, staff have been designated as the initial line of quality assurance. By attacking the problem at its primary point where the majority of possible errors may occur, which is where the front end loading of the data from the court order happens, the quality assurance staff will be in position to locate patterns of difficulties. This early detection system will identify staff that will either receive remedial training or be replaced by individuals that can perform.*

- *OAG is planning to make programming improvements to calculate arrears automatically, after initial data is entered from the court order. This automation will reduce data entry errors, and arithmetic errors associated with manual processes.*

- *To further enhance data entry efforts several scanning devices were piloted at various field units. However, these devices proved unsuccessful due to their inability to accurately discern handwritten instructions appearing in court orders.*

  *Efforts continue to identify equipment capable of electronically transferring court order requirements to the child support automated system.*

*The Internal Audit Division also completed a review of the causes of inaccurate Child Support balances in the summer of FY 1995. This review included recommendations and ideas for improving controls regarding the accuracy of arrearage balances. Some of these recommendations and ideas included improvements for training, testing, and certification of arrearage calculators; timely validation of arrearage data at the point of data entry; and continued monitoring of arrearage balances and consideration of statistical control techniques for ensuring accurate balances.*

# State Compliance Issue

STATE COMPLIANCE ISSUE 1:

## Ensure Compliance with State Requirement to Accrue Interest on Delinquent Child Support

**The Office of the Attorney General (Office) did not comply with state requirements to accrue interest on delinquent child support**. Noncompliance results in understated arrearage balances presented in court and used for interception of income tax refunds. Custodial parents may not receive the full amount owed. Also, proper reimbursement may not be made to the *Aid to Families with Dependent Children* (CFDA 93.560) *(Family Support Payments to States - Assistance Payments)* program.

The automated Child Support Enforcement System is unable to accrue interest on child support arrearages. Additionally, the Office does not have procedures to manually calculate this interest on arrearage balances.

Section 14.34 of the *Texas Family Code* requires that interest be added to past due child support from court actions on or after September 1, 1991.

Recommendations:

We recommend that the Office comply with state requirements to accrue interest on delinquent child support. The current Child Support Enforcement System should be modified to include interest on arrearage balances. Additionally, the Office should develop procedures to manually calculate interest on child support arrearage balances until the current system is modified. At a minimum, arrearage balances presented in court should include interest.

*Management's Response*:

*This condition has been documented previously and will continue to some degree, until our newly automated system fully addresses the problem.*

*We are developing a PC based program to calculate interest until TXCSES is implemented. This PC based program has been piloted in various field units and should be available to field units in the spring of 1996. The new system is scheduled to be implemented in November, 1996. The Child Support Division will obtain the necessary approval from the Federal Grantor for these expenditures.*

*Finally management will continue to dispense its Program Monitoring and local regional quality assurance staff to routinely review all corrective actions taken to document both successes and deviations in calculations.*

## 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, and allowability of costs. Specific procedures were used to test compliance with the major federal program. In fiscal year 1995, over $491 million in child support payments were processed through the Child Support Enforcement Trust Fund. Federal expenditures to administer the Program totaled $103 million during the same period.

## Overall Conclusion

A material control weakness exists in the reporting system used to compile the State's *Comprehensive Annual Financial Report (CAFR)*. The initial draft of the *CAFR* contained significant reporting errors which were later corrected for the final report. These errors were caused by lack of a self-balancing set of accounts, extensive manual procedures, and lack of sufficient time to ensure accuracy of the data. Collectively, these conditions comprise a material control weakness. This weakness increases the risk that material errors in the *CAFR* could occur and go undetected within a timely period by employees performing their normally assigned duties. However, nothing came to our attention that would indicate state funds were lost as a result of this weakness.

## Management's Response to Key Points of Report

*We do not agree that there is a material weakness in internal controls. Generally Accepted Auditing Standards defines a material weakness as a "condition 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 or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions." We acknowledge improvements can be made in the statewide consolidation and Comprehensive Annual Financial Report (CAFR) preparation; however, the conditions described in the State Auditor's Office (SAO) report as material weaknesses do not meet this definition. The primary issues raised by the audit focused on the initial draft of the CAFR. The condition which resulted in subsequent adjustment to the CAFR was detected by the Comptroller's Office prior to submittal of the draft CAFR to the SAO. The adjustments were made to the CAFR by the Comptroller's Office prior to the annual statutory deadline.*

*It is important to note that the conditions referred to as material weaknesses by the SAO relate only to the process of consolidating data into the annual CAFR. This process requires compilation of information from over 200 agencies and universities under the highly compressed time line required by statute, making it unlikely that a draft would be produced which would not require subsequent modifications. The actual recording of revenues, expenditures, assets and cash balances is sound and there is no condition noted that would indicate any potential for loss of accountability for any state funds or assets. Further, we believe that the statement by the SAO under the Key Facts and Findings "The current method of accounting caused significant financial reporting errors" is incorrect. This is evident by the SAO issuance of a clean opinion on the fiscal year 1995 CAFR which, were this statement true, would not have been possible.*

*Improvements in the CAFR preparation process were made during the current year. Further, Comptroller staff is aggressively pursuing additional improvements to the process and will continue to inform SAO as resolutions are determined.*

Auditor's Follow-up Comment:

In our judgment, the conditions mentioned constitute a material weakness due to the following:

- The errors were material to the financial statements. The amount of the errors, $763 million, represented approximately 19 percent of the total assets of the State's General Revenue Fund. The General Revenue Fund balance increased over 300 percent after the errors were corrected.

- Report adjustments for the General Revenue Fund are made using one-sided entries. As a result, the Comptroller's Office cannot ensure that it has correctly identified, balanced, and reported all the effects of an adjustment. This negates the basic control of a double-entry accounting system, which assures that the effects of transactions are balanced at the time they are entered. This problem can best be addressed by using a double-entry system for reporting purposes that accounts for all General Revenue Fund transactions.

- The errors were not detected in a timely period. The draft of the *CAFR* given to the State Auditor's Office for opinion contained material errors. The misstated accounts were identified and corrected for the published version of the *CAFR* after the State Auditor's Office indicated it would have to issue an opinion stating that the General Revenue Fund was not accurately reported.

- The errors were not investigated and corrected by employees in the normal course of performing their assigned functions. In order to detect which accounts were misstated and to correct the errors, the Comptroller's Office and the State Auditor's Office expended significant additional time and effort. In addition, the Comptroller's Office relied upon a former employee to identify a significant portion of the errors.

Turnover for the 1995 reporting period reduced the experience level of the financial reporting team and, consequently, increased the risk of reporting errors for the CAFR. The recent vacancy in the financial reporting manager's position also increases the risk of errors in the future.

The Comptroller's Office is responsible for controls to ensure the accuracy of the data in the *CAFR*. Until conditions comprising the material weakness are addressed, similar errors could occur and remain unidentified in future years.

## Prior Audit Issues

The Comptroller's Office has resolved prior audit recommendations to provide assurance that the State's financial reporting entity is properly defined and reported. The Comptroller's Office has also improved the system used to reconcile cash between the Uniform Statewide Accounting System (USAS) and the Treasury's cash accounting system.

## Related Audit Report

In response to prior audit recommendations, the Comptroller's Office has developed a plan to use USAS to produce the *Comprehensive Annual Financial Report (CAFR)*. The plan is in progress; however, certain technical and policy issues need to be resolved in order for USAS to fully produce the *CAFR*. The State Auditor's Office reported on these issues in January 1996. See *Audit Report on the Uniform Statewide Accounting System* (SAO Report No. 96-037).

## Accounting and Reporting Issues

ACCOUNTING AND REPORTING ISSUE 1:

### Properly Record and Report General Revenue Fund Activity

(Prior Audit Issue)

**The Comptroller's Office does not use a self-balancing set of accounts to record and report General Revenue Fund activity in the *Comprehensive Annual Financial Report (CAFR)*.** The lack of balancing controls contributed to initial reporting errors of $763 million in the General Revenue Fund.

The State Auditor's Office has reported the need for a self-balancing set of accounts to report General Revenue Fund activity since 1990; however, the issue has not been resolved. The Comptroller's Office has responded that implementing the statewide accounting system, USAS, would resolve the problems. Although USAS was implemented on September 1, 1993, it is not used to compile the *CAFR* or to report all General Revenue Fund activity. The Comptroller's Office has developed a plan to produce the *CAFR* from USAS; however, certain technical and policy issues need to be resolved in order for USAS to fully produce the *CAFR*.

The General Revenue Fund is the State's principal operating fund and is used to account for the State's general activities and financial resources. It includes assets of $4 billion, revenues of $34 billion, and expenditures and transfers of $36 billion for the fiscal year ended August 31, 1995. Under the current process, manual adjustments are necessary to account for cash balances in the State Treasury, revenues, expenditures, and transfers between the General Revenue Fund and other funds that are not included in individual agency financial statements. Adjustments are also necessary to eliminate agency balances not applicable on a statewide basis.

Generally Accepted Accounting Principles state that governmental accounting systems should be maintained with a self-balancing set of accounts within each fund. The purpose of this standard is to help ensure accurate financial statements by preventing reporting errors.

Recommendation:

We recommend the Comptroller's Office implement a self-balancing set of accounts to record and report General Revenue Fund activity. Until USAS is used to compile the *CAFR* and report all General Revenue Fund activity, balancing controls should be developed to prevent reporting errors.

*Management's Response*:

*The automated Uniform Statewide Accounting System (USAS) currently provides a self-balancing set of accounts to record General Revenue Fund Activity at the agency level. The Financial Reporting system utilized for the preparation of the Consolidated Annual Financial Report (CAFR) currently does not utilize a self-balancing dual entry set of accounts for recording statewide adjusting and consolidating entries. While the underlying financial data for the individual agencies is recorded in USAS, these adjusting and eliminating entries must be made to present the Statewide Financial Statements in accordance with Generally Accepted Accounting Principles (GAAP).*

*We recognize that opportunities exist to improve the financial reporting process, and have chosen to address financial reporting systematically as part of the development of USAS. Efforts to date have been focused on those developmental issues that lay the necessary foundation for financial reporting. In the interim we have elected to rely on the current procedures for preparing the CAFR which were jointly developed by the State Auditor's Office (SAO) and the State Comptroller's Office. These procedures have been in place for the last nine years since the preparation of the first CAFR in 1987 and contain balancing controls to compensate for the lack of self-balancing accounts. These procedures have been utilized while the implementation of USAS has been underway because they have proven reliable in preparing a CAFR which has received the GFOA's Certificate of Achievement for Excellence in Financial Reporting for the past five years.*

*The need to enhance the CAFR preparation process to record adjusting and eliminating entries in the General Revenue Fund utilizing dual entry accounting has not been ignored. We have been working closely with the SAO and agencies to move toward preparing the CAFR by compiling financial information maintained on USAS and moving away from the current process. A team continues to develop* *recommendations on how USAS can be utilized to support CAFR development by providing a self-balancing set of accounts and to record and report General Fund Activity.*

*While the Comptroller's efforts to revise policies and procedures and train agencies on the use of USAS will go a long way toward achieving compliance with a self-balancing set of accounts, agency compliance, supported by periodic field work audits performed by the SAO, will be necessary to achieve this goal.*

Auditor's Follow-up Comment:

Again, report adjustments for the General Revenue Fund are made using one-sided entries. As a result, the Comptroller's Office cannot ensure that it has correctly identified, balanced, and reported all the effects of an adjustment. This presents a reporting problem that can best be addressed by using a double-entry system that completely accounts for all General Revenue Fund transactions.

Within the current reporting system, balancing controls were ineffective since accounts were out of balance by $763 million. Without a self-balancing system, identifying errors depends heavily upon the staff's personal knowledge of the system and complexities of various state agencies rather than upon checks and balances that could be built into the system. The out-of-balance amount occurred despite detailed initial analysis of the information by the Comptroller's staff. A significant portion of the errors was eventually identified by the former Financial Reporting Manager, who was contacted by the Comptroller's Office to provide assistance.

Current employee turnover within the same position increases the risk of similar errors in the future.

ACCOUNTING AND REPORTING ISSUE 2:

## Improve the State's Financial Reporting Process

(Prior Audit Issue)

**The Uniform Statewide Accounting System (USAS) is not used to generate the State's *Comprehensive Annual Financial Report (CAFR)*.** Extensive manual processes and lack of timely information decrease the time the Comptroller's Office has available to ensure the accuracy of information. This increases the risk of errors and delays in producing the *CAFR*.

The following specific conditions contribute to the difficulty of manually compiling the State's financial information:

- The Comptroller's Office compiles its financial position once a year by an extensive, mostly manual, consolidation of the relevant financial data. The data is obtained from over 200 agency and university annual financial reports and analysis of information on USAS.

- Late and/or inaccurate agency and university annual financial reports cause delays. Thirteen state agencies did not submit their reports on time. (See Exhibit 1.) Several other timely reports were inaccurate and had to be revised.

- External independent auditors may not prepare audited reports in accordance with state reporting guidelines or time frames. No deadline has been established for the audited reports. Ten agencies receiving independent external audits submitted reports between one to two months past the reporting deadline for unaudited reports. (See Exhibit 2.)

The Comptroller's Office has to make adjusting entries when the agencies submit late or inaccurate information. Adjustments may affect multiple sections within the *CAFR* and require considerable time to ensure changes are properly reported.

The State's audited financial statements have to be completed by the end of February to comply with state statute and other reporting requirements. Currently, state statute requires agencies and universities to submit financial statements by November 29 in order to meet the February deadline.

Recommendation:

Until USAS is used to produce the *CAFR*, we recommend the Comptroller's Office improve the State's financial reporting process by considering the following procedures:

- Identify additional opportunities for automation such as requesting agency information in a standard automated format.

- Request that the agencies submit their annual financial reports by an earlier date. An initial due date of November 15 with the goal of October 31 in subsequent years may be reasonable.

- Issue requirements for agencies contracting with independent auditors which establish specific deadlines and report requirements.

The State Auditor's Office is available to assist the Comptroller's Office in identifying opportunities for automation and for communicating with agencies and independent auditors the importance of timely and accurate annual financial reports.

<u>*Management's Response*</u>:

*We agree and fully support finding ways of enhancing use of technologies that may be available to automate more of the CAFR preparation. We are committed to finding ways to eliminate manual processes used during the compilation. Options will be explored.*

*We agree that earlier Agency Annual Financial Reports submission dates should be considered and are currently researching submission requirements other states have. However, the problems are not only late submission but additional changes that are requested by agencies subsequent to the initial annual financial report. Additional compilation and auditing is then required. We will continue to work with SAO to find ways of alleviating these types of problems.*

*Again, legislation and changes in reporting requirements will be considered to address independent auditors' reports. SAO may consider initiating contracts with agencies to ensure timely independent audits are performed in accordance with current financial reporting requirements.*

*In addition, Exhibit 2, listing late received audited reports, does not include Teacher Retirement System (TRS). We did not receive adjustments until late January which caused a delay to the compilation of the CAFR.*

ACCOUNTING AND REPORTING ISSUE 3:

## Improve Accuracy of Budget Statement Information

**The Comptroller's Office does not have adequate procedures to ensure the accuracy of budget statement information.** The initial draft of the budget statement overstated budgeted revenues by $251 million and understated budgeted expenditures and beginning fund balances by $53 million and $173 million, respectively.

The following are examples of specific conditions contributing to these inaccuracies:

- Current review procedures do not ensure that the data is accurate and complete. Budgeted revenues included estimated revenue sources which were reported in error. We noted the same error in the previous year. In addition, the Comptroller's Office did not ensure that budgeted expenditures reflected all legislative appropriations. As a result, legislative increases to expenditures for employee pension and insurance benefits were not reported.

- There is no automated system to prepare the budget statement. The Comptroller's Office gathers data from several sources, including revenue estimation, appropriations control, and financial reports from over 200 agencies and universities. The data is then manually classified in order to properly match budgeted and actual revenues and expenditures. This process increases the risk of errors.

- The Comptroller's Office has not formally identified and defined all items that should be included in the budget statement. For example, available balances from previous appropriations were not initially included in the beginning balances.

Generally Accepted Accounting Principles require that a budget statement be presented as part of the financial statements for governmental entities. This allows financial statement users to compare the legally adopted budget with the actual revenues and expenditures. Errors in the statement increase the risk that financial statement users may rely upon inaccurate information.

Recommendation:

We recommend the Comptroller's Office develop the following procedures to improve the accuracy of the budget statement information:

- Perform a more thorough quality control review of all information for accuracy and completeness to ensure the budget statement reflects the legally adopted budget and the planned financing of the State.

- Consider automating the use of different sources of information to prepare the statement.

- Identify and define appropriate data to be included in all budget categories.

*Management's Response*:

*We believe there are adequate procedures in place to ensure the Combined Statement of Revenues, Expenditures, and Changes in Fund Balance--Budget and Actual schedule is accurate. The method used to report this schedule was jointly developed by the SAO and the State Comptroller's Office and has been in place for the last nine years since the first publication of the CAFR in 1987. The understatement of beginning fund balance is an adjustment recommended by SAO relating to the fiscal year 1994 budget schedule. In the budget schedule in prior years, fund balance was not included as an adjustment.*

*Historically, this has not been an adopted adjustment. Generally Accepted Accounting Principles do not require the inclusion of fund balance in the budget exhibit.*

- *This year a quality control process was implemented to review steps performed during compilation of statements, adjustments, and notes. Due to time constraints of auditing the budget schedule, the SAO requested the budget exhibit before a* *thorough review could be performed. However, samples of budget adjustments and compilation were reviewed prior to giving them to the SAO. No problems were detected during the review. We will explore other alternatives and will seek suggestions from SAO on improvements.*

- *Our office will consider automating different sources of information used to prepare the schedule. In addition, methods used by other states will be explored to determine if an efficient and cost effective process exists. Automation of actual data from the budget schedule is dependent upon agencies entering reliable and timely data in USAS. Agencies continue to make progress in this area. However, periodic field work audits by SAO will be necessary to ensure accuracy of financial data.*

- *The methodology jointly designed by SAO and our office will be reconsidered.*

Auditor's Follow-up Comment:

The procedures the Comptroller's Office used to review the accuracy of the information were ineffective. In some cases, the same errors were repeated from the previous year. Procedures need to be improved to increase the accuracy of budget statement information.

The Comptroller's Office is responsible for developing procedures to ensure the accuracy of the budget statement. The State Auditor's Office is responsible for attesting to the accuracy of that information.

## Federal Compliance Issue

FEDERAL COMPLIANCE ISSUE 1:

### Calculate and Report Federal Interest Liability

**The Comptroller did not calculate or report a federal interest liability for the *State Legalization Impact Assistance Grants (SLIAG)* program (CFDA 93.565).** As a result, the State's federal interest liability may be understated by the amount of interest associated with the $55 million in *SLIAG* funds received during fiscal year 1995. Interest liabilities are based on the number of days the State held federal funds.

The Comptroller is the State's designated Cash Management Improvement Act (CMIA) representative. As such, the Comptroller is responsible for compiling information from state agencies, performing interest calculations, and reporting the State's federal interest liability.

According to the *Treasury-State Agreement, Part V, § 5.1.27,* the *SLIAG* program is subject to the pre-issuance funding technique. *Part VII, § 7.1* requires the State to prepare interest calculations to determine the annual federal interest liabilities for pre-issuance programs. An interest liability must always be computed for the federal programs under the pre-issuance technique. The liabilities are reported on the *CMIA Annual Report*, and the interest is paid to the U.S. Treasury.

We understand the Comptroller is currently negotiating with the U.S. Treasury to exclude *SLIAG* funds from the *Treasury-State Agreement.* However, the omission of the 1995 interest liability for *SLIAG* constitutes noncompliance with the current Agreement.

Recommendation:

We recommend the Comptroller calculate and report the interest liability for the *SLIAG* program, in accordance with the current *Treasury-State Agreement.* A revision to the *1995 CMIA Annual Report* should be made to report and pay the *SLIAG* interest as required, or as negotiated by the U.S. Treasury.

*Management's Response*:

*The State Legalization Impact Assistance Grants (SLIAG) program (CFDA 93.565) was addressed in the amendment to the CMIA agreement that covered the state's fiscal year 1995. In negotiations with the federal Financial Management Service (FMS), while preparing the fiscal year 1995 amendment, the state's first draft amendment proposed to exclude this program because it was scheduled to expire at the end of fiscal 1994. In addition, the expenditures for this program in fiscal year 1994 were below the State's threshold for major federal programs. The FMS insisted that the program be included, and it was included in the final version of the amendment, but with the notation concerning the fiscal year 1994 expiration date. Clearance patterns were not prepared for this program in preparation for the fiscal year 1995 CMIA report because, based on agency input, the total amount drawn was expected to be immaterial. In addition, this program represents reimbursements made by the federal government to states and to local governments making claims through the states.*

*State agencies subject to the CMIA were requested to report the amount of their fiscal year 1995 drawdowns to support the contention that the amounts were immaterial. Several agencies submitted data showing the receipt of SLIAG funds during the year. The amounts reported were larger than originally represented, and were material in nature. This development was totally unexpected in that the expectation was, based upon prior discussion of this issue, that the amounts reported for this program would be immaterial, and thus below the CMIA threshold. No interest liability related to the program included in the fiscal year 1995 federal report because 1) the Comptroller did not have the data available to compute such a liability in a timely manner, and 2)* *the reimbursement nature of the program raised questions about whether a liability should be calculated. We have begun discussions with the FMS on this issue. We received a letter from our FMS contact stating that in the event it is decided that an interest liability is associated with the program for fiscal year 1995, it can be handled as a prior year adjustment in the fiscal year 1996 CMIA report.*

## Audit Scope

The primary focus of the audit work at the Comptroller's Office was the statewide consolidation process. 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 200 state agencies, universities, and component units. We also gained an understanding of procedures the Comptroller's Office used to comply with the requirements of the Cash Management Improvement Act (CMIA).

EXHIBIT 1:

## Agencies Submitting Late Annual Financial Reports

The following agencies did not submit their annual financial reports by the November 29, 1995, statutory deadline:

| Agency | Date Received |
|---|---|
| Soil and Water Conservation Board | 12/12/95 |
| Advisory Commission on State Emergency Communications | 12/8/95 |
| Texas Turnpike Authority | 12/8/95 |
| Stephen F. Austin State University | 12/8/95 |
| Board of Chiropractic Examiners | 12/5/95 |
| Food and Fibers Commission | 12/4/95 |
| Texas Lottery Commission | 12/1/95 |
| Adjutant General's Department | 12/1/95 |
| State Anatomical Board | 12/1/95 |
| Texas Education Agency | 12/1/95 |

| Agency | Date Received |
|---|---|
| Legislative Reference Library | 11/30/95 |
| Board of Law Examiners | 11/30/95 |
| Southwest Collegiate Institute for the Deaf | 11/30/95 |

EXHIBIT 2:

## Agencies Submitting Audited Annual Financial Reports after January 1

The following agencies submitted their audited annual financial reports after January 1, 1996. No standard deadline currently exists for audited annual financial reports. The statutory deadline for unaudited reports was November 29, 1995. The statutory deadline for the audited *CAFR* was February 29, 1996.

| Agency | Date Received |
|---|---|
| Texas Department of Housing and Community Affairs* | 2/14/96 |
| Texas Turnpike Authority | 1/22/96 |
| Texas Lottery Commission** | 1/16/96 |
| Employees Retirement System | 1/16/96 |
| Permanent School Fund | 1/12/96 |
| Permanent University Fund | 1/12/96 |
| Texas Guaranteed Student Loan Corporation | 1/12/96 |
| Texas A&M University Research Foundation | 1/12/96 |
| Texas Workers' Compensation Insurance Fund | 1/8/96 |
| Texas Local Government Investment Pool | 1/8/96 |

*Statutory deadline for submitting audited annual financial report is March 1.
**Statutory deadline for submitting audited annual financial report is April 1.

## Overall Conclusion

The Texas Education Agency (Agency) has not fully implemented procedures to adequately protect its automated environment. In addition, the Internal Audit Division (Division) is not effectively monitoring the operations of the Agency and, as our previous year's audit indicated, the Division has never received a peer review.

The Agency is in compliance with most federal regulations related to the $1.6 billion of federal funds disbursed in fiscal year 1995.

## Other Related Reports

The State Auditor's Office is currently conducting a financial compliance audit that provides an assessment of the Texas Education Agency's monitoring systems for public education. The scope of audit work includes the review of the monitoring functions of the following federal programs: Accelerated Instruction, Bilingual Education, Career and Technology, Migrant Education, National School Lunch, School Breakfast, and Special Education. The estimated report release date for this audit is July 1996.

## Internal Control Issues

INTERNAL CONTROL ISSUE 1:

### Fully Implement and Enforce Access Security Policies and Procedures

(Prior Audit Issue)

**Access security policies and procedures have not been fully implemented**. In addition, adequate personnel resources have not been assigned to ensure these security policies and procedures are implemented, monitored, and enforced. Without the implementation and enforcement of security policies and procedures, automated information used to support the administration of federal programs becomes susceptible to improper modifications or deletions.

The Agency's automated systems collected and processed $1.6 billion of federal funds in fiscal year 1995.

Recommendation:

We recommend that the Agency continue implementation of its security policies and procedures. The Agency should also assign additional personnel resources to ensure that implemented procedures can be monitored and enforced.

*Management's Response*:

*The Texas Education Agency agrees with the audit finding and recommendation. Effective January 29, 1996, information security will be combined with the contingency planning function under the supervision of a Grade 21. During the same time frame, a Grade 18 Security Analyst position vacancy will be posted to augment the security function primarily for the purpose of monitoring automated security using automated audit tools. An Agency Operating Procedure for Information Resource Security was reviewed by the Director's Advisory Council on January 26th and should be approved and published by the end of February. Additionally, an inventory of all automated systems has been made and as soon as the Security Analyst position is filled, comprehensive security information about each system will be collected. This project should be complete by the end of fiscal year 1996.*

INTERNAL CONTROL ISSUE 2:

## Improve the Effectiveness of the Internal Audit Program

(Prior Audit Issue)

**The Texas Education Agency's Internal Audit Division's (Division) audit program is not effectively monitoring the operations of the Agency**. By complying with the *Texas Internal Auditing Act*, the Division's audit program would be more effective and would address the following deficiencies:

- The Division's current risk assessment does not address an overall control assessment for the Agency's major systems and controls. As a result, planned audit work may not provide the necessary information to determine the achievement of the Agency's objectives.

- There was no documentation of deviations from the audit plans nor were there any audit plan amendments made over the past two years. The Division completed less than 15 percent of the approved, planned audits over the past two years. On the average, the Division performed one planned audit and two requested audits per year. By not addressing the audit plan in a timely manner, management takes the risk that the Agency is not effectively accomplishing its goals and that controls may not be adequate or operating as intended.

- The Division has yet to receive a peer review of its audit program. The peer review scheduled for August 1995 was not performed. Therefore, the Division may have delayed opportunities for improving its function and operation.

An internal audit program provides a mechanism for quality control to ensure that the entity is accomplishing its goals efficiently and that the appropriate internal controls are operating. The *Texas Internal Auditing Act* specifies that the internal audit program should have an annual audit plan that is prepared by using risk assessment techniques that identify the agency's major systems and controls. In addition, a peer review should be performed periodically that evaluates the operations of the internal audit department and identifies areas for improvement.

<u>Recommendation</u>:

We recommend the Division improve the effectiveness of its internal audit program. Complying with the *Texas Internal Auditing Act* would assist in this improvement. Specifically, the Division should improve its monitoring of the Agency's operations by performing an assessment of the major control systems. Also, deviations from the audit plan should be documented and approved by the Commissioner. Finally, the Division should participate in a peer review.

*<u>Management's Response</u>*:

*We concur with the auditor's recommendation. The Agency's Internal Audit Division will address the recommendations by complying with the Texas Internal Auditing Act. Specifically, the Division will revise its risk assessment to address the Agency's major control systems by July 1996. In addition, quarterly meetings will be held with the Commissioner to address any deviations from the current audit plan. The results of these meeting will be documented and, if necessary, the plan revised. Finally, the Division has been in contact with the State Agency Internal Audit Forum (SAIAF) Peer Review Committee to have a peer review conducted by May 1996.*

## Accounting and Reporting Issue

ACCOUNTING AND REPORTING ISSUE 1:

### Promote Adherence to Generally Accepted Accounting Principles

**The Texas Education Agency waived Generally Accepted Accounting Principles (GAAP) for 32 independent school districts**.

- Thirty independent school districts requested waivers for accruing August salaries. The amount of payroll accruals waived for 24 of the 30 independent school districts were in excess of $52.8 million.

- Two additional independent school districts were exempt from recording a long-term liability for financial obligations relating to early employee separation from a contract.

As a result of these departures, the financial position of these districts may have been misrepresented during the year, and therefore, decisions relying on this financial information may have been adversely influenced.

Generally Accepted Accounting Principles state that the modified accrual accounting method serves as the basis of governmental accounting. Expenditures are recorded when the related liability is incurred. In addition, estimated liabilities, that will eventually impact financial resources, are recorded as long-term debt.

<u>Recommendation</u>:

We recommend the Texas Education Agency promote school districts' adherence to Generally Accepted Accounting Principles.

*<u>Management's Response</u>*:

*We concur with the auditor's recommendation. The School Financial Audits Division of the Texas Education Agency also concurs with the State Auditor's recommendation that the school districts adhere to Generally Accepted Accounting Principles. It should be noted that the Texas Education Agency granted certain financial accounting related temporary waivers because of the financial situations in 32 districts. The School Financial Audits Division also concurs that this type of waiver should not be granted under any circumstances.*

## Federal Compliance Issue

FEDERAL COMPLIANCE ISSUE 1:

### Strengthen Controls over Cash Management for Subrecipients

**The Texas Education Agency should strengthen its controls over cash management for subrecipients**. The Agency did not follow established procedures to monitor subrecipient cash needs and adjust subsequent cash advances. As a result, excess cash balances were identified for 2 of the 12 (17 percent) subrecipients tested, which represents noncompliance with federal regulations. In addition, four other subrecipients had deficit balances, because the Agency failed to adjust cash advances accordingly.

Federal regulations require that federal funds be requested to meet immediate cash needs. *Title 34 of the Code of Federal Regulations (CFR), § 80.20(b)(7)* states that procedures minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees must be followed whenever advance payment procedures are used.

The two subrecipients with excess cash balances received funding from the following federal programs: *Title 1 Grants to Local Education Agencies* (CFDA 84.010) and *Safe and Drug-Free Schools - State Grants* (CFDA 84.186).

Recommendation:

We recommend the Agency strengthen its controls over cash management for subrecipients. The Agency should consider adding an automated edit check or a secondary review, if using a manual system, to ensure that monitoring procedures are consistently followed.

*Management's Response*:

*We agree with this recommendation. The Agency is in the process of developing an automated system that will significantly strengthen its controls over subrecipient cash disbursement functions. The Integrated Funds Management (IFM) system currently under development contains an Administer Funds module that will automate subrecipient cash disbursements. This automation will enhance Agency staff's ability to monitor, control, and manage subrecipient cash disbursements.*

*Until such time as the IFM system is implemented, the divisions of Accelerated Instruction, Migrant Education, and Special Education will refine and strengthen existing cash management procedures. The three divisions will also standardize their cash management procedures to the extent allowable by each division's cash disbursement process. These modifications will ensure that the required monitoring, control, and management of subrecipient cash disbursements is conducted in such a way as to provide appropriate amounts of cash to subrecipients thus enabling them to conduct project activities.*

*In accordance with the recommendation of the Office of the State Auditor, the divisions of Accelerated Instruction, Migrant Education, and Special Education will also develop and implement a secondary review process. The new review process will consist of quality control inspections conducted on a judgmental sample of two percent of each program's monthly cash activity.*

*Full implementation of the IFM system is not expected until 1998 or 1999. However, the Agency anticipates being able to fully implement the modifications to current cash management procedures as well as the secondary review process by March 1, 1996.*

## Audit Scope

The primary focus of our audit was the Agency's financial and administrative controls over $1.6 billion of federal funds expended during fiscal year 1995. We gained an understanding of the internal control structure, including the general control environment, and tested controls related to federal programs and cash disbursements. Specific procedures were used to test compliance with the major federal program requirements.

## Overall Conclusion

The General Services Commission (Commission) has made significant progress by resolving 8 of the 11 outstanding prior year issues related to the *Donation of Federal Surplus Personal Property* program. Although the magnitude of issues identified in prior years prompted the Commission to restructure the Surplus Property Division, two areas of material noncompliance continue to exist. Specifically, the Commission is not maintaining current eligibility records or monitoring the use of property donated to donees. As a result, total questioned costs of $12,194 occurred in the program. The program received approximately $35 million of federal property valued at original acquisition cost.

"Material noncompliance" is a failure to follow federal program requirements in a significant number of instances.

## Commission's Improvements

The Commission began many initiatives during the second quarter of fiscal year 1995 to improve program management in the Surplus Property Division. The Commission started by analyzing costs and reducing personnel to decrease operating costs. Expenditure reductions continue to be evaluated on a monthly basis. To enhance revenue, a property coordinator has been assigned to contact potential and existing donees on a monthly basis to heighten program awareness and assess customer needs. As a result, the sustained loss of approximately $760,000 in fiscal year 1994 has been decreased to approximately $13,000 for fiscal year 1995.

In addition, the Commission has resolved a majority of the recurring program weaknesses that have existed since fiscal year 1991 (see Exhibit 1). While a few instances of noncompliance continued to exist in fiscal year 1995, the Commission has already taken corrective action and resolved the issue related to maintaining current and accurate eligibility records for fiscal year 1996.

The Surplus Property Division administers the *Donation of Federal Surplus Personal Property* program (CFDA 39.003), which is the Commission's largest federal program. The program received approximately $35 million of federal surplus property valued at original acquisition cost and generated $3 million in program income from service and handling fees in fiscal year 1995.

## Internal Control Issue

INTERNAL CONTROL ISSUE 1:

### Ensure Inventory Is Counted When Received

**The Commission is not consistently counting inventory when it is received.** As a result, inventory shortages ranged from 10 percent to 91 percent of the amount received, resulting in questioned costs of $1,514. The shortages occurred at the Houston, Fort Worth, and Lubbock districts. Examples of the shortages are listed in Figure 1. Although program management suspects theft in some cases, existing controls do not completely deter theft.

Figure 1

| Inventory Item | Amount Received | Units Short | Value of Shortages [1] | Percent Variance |
|---|---|---|---|---|
| Pad Rubber Finger | 239 | 24 | $ 2.24 | 10% |
| Air to Ground Jacket | 228 | 52 | $108.68 | 23% |
| Hearing Band | 440 | 150 | $141.90 | 34% |
| Staple Cable | 300 | 144 | $108.67 | 48% |
| Chair | 34 | 18 | $209.70 | 53% |
| Blade Saw | 8 | 7 | $ 22.07 | 88% |
| Bar Metal | 42 | 38 | $ 28.60 | 91% |

Source: General Service Commission, Federal Surplus Property program (unaudited)

[1]Used property is valued at the reduced cost of 23.3 percent of the original acquisition cost.

Controls have been designed for recording property when it is received. Due to prior audit issues, periodic supervisory reviews have been implemented. However, the receiving clerk is not adhering to the controls on a routine basis. Inventory controls ensure that property is safeguarded against loss and unauthorized use.

*The Code of Federal Regulations (CFR), Title 41, §§ 101-44.204* and *101-44.205*, require the Commission to have procedures and facilities to ensure that surplus property is properly accounted for and adequately warehoused.

Recommendation:

The Commission's personnel should consistently count all inventory when it is received. Existing controls should continue to be emphasized and additional controls should be developed to detect and prevent theft. To further enhance accountability, an analysis of inventory shortages should be performed by program management on a routine basis to detect weaknesses in the inventory system.

Management's Response:

*We concur with this recommendation. The General Services Commission's Federal Surplus Property division processed a wide variety of federal surplus property with an estimated original acquisition cost of $51,528,908 for 1995. The questioned costs of $1,514 represents items which are high in unit count and easily removed from the premises. Future receipt of similar type items will be handled by enforcing existing procedures with an emphasis on District Director follow-up and adherence to accurate count procedures by district Receiving Clerks. A memo has been sent to all District Directors and Receiving Clerks emphasizing the importance of using existing controls and resulting disciplinary action for failure to adhere to established requirements.*

*Additional controls will be used to detect and prevent loss as follows: 1) checking photo identification of all personnel entering the warehouse, 2) training district personnel for awareness of potential donee theft, 3) training district personnel to count and inspect all items before loading donee vehicle, and 4) increasing monitoring of receiving and loading areas by district management. District Directors will perform quarterly analysis of the "Inventory Adjustment Report." The analysis will be forwarded to the Procurement/Inventory Manager with an explanation and recommendations concerning findings. The Procurement/Inventory Manager will further investigate, if needed, and submit report of findings to the General Services Administration and the General Services Commission's Program Administrator. Any inventory shortage issue identified by the General Services Administration as significant will be further investigated until adequately resolved to meet federal requirements.*

## Federal Compliance Issues

Our audit included evaluating compliance with federal regulations governing the appropriate use of surplus property, donation to eligible donees, maintenance of current and accurate eligibility files, and implementation of adequate controls to account for and store inventory. The examination was conducted at the Houston, Lubbock, and Fort Worth district warehouses.

Recommendations addressed in the Internal Control section 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:

## Maintain Current and Accurate Eligibility Records

(Prior Audit Issue)

**The Commission did not update all eligibility records of donees to maintain current and accurate information.** Sixty percent (18 out of 30) of the donees tested did not have a current authorized representative form. This represents material noncompliance with federal regulations regarding eligibility. Since program clerks rely on the authorized representative form to identify eligible donees, outdated forms could provide opportunities for ineligible donees to obtain federal surplus property.

According to program management, conflicting policies and procedures for updating the form existed in fiscal year 1995. Program personnel were following an informal procedure for updating the form instead of the Commission's written policy.

The Commission revised its policies and procedures for updating eligibility records in fiscal year 1996. All eligibility records are currently being reviewed and updated for donees participating in the *Donation of Federal Surplus Personal Property* program.

*The Code of Federal Regulation (CFR), Title 41, § 101-44.207* requires the Commission to update eligibility records as frequently as necessary to ensure that information is current and accurate.

Recommendation:

The Commission should continue its efforts to maintain current and accurate eligibility records. Ensuring that personnel are aware of and following current policies and procedures for updating eligibility records is critical to this effort.

*Management's Response*:

*We concur with this recommendation. The General Services Commission will continue to maintain current and accurate eligibility records. The General Services Commission, General Services Administration, and the State Auditor's Office met on June 14, 1995 to clarify and establish current file maintenance and eligibility guidelines. The revised processing sampled by the State Auditor's Office for current 1996 showed 100% compliance which is the continued goal for this effort.*

FEDERAL COMPLIANCE ISSUE 2:

## Comply with Monitoring Procedures at the Fort Worth District

(Prior Audit Issue)

**The Fort Worth district did not monitor for proper use of donated property.** As a result, questioned costs of $10,680 and material noncompliance with federal utilization requirements occurred. The Fort Worth district processed 25 percent of total surplus property donated in fiscal year 1995.

The Commission has established procedures for monitoring the use of federal surplus property donated to donees; however, these procedures were not followed until May 1995. 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.

Currently, the program auditor is overseeing the district's monitoring efforts for compliance with proper use of donated property. Although monitoring was not performed on a timely basis, follow-up procedures for fiscal year 1995 were completed.

*Code of Federal Regulations (CFR), Title 41, § 101-44.208,* requires the Commission, through the use of utilization surveys and reviews, to ensure that donated property meeting certain criteria (compliance item) is placed in use within one year of its donation. During the one year period of restriction, the donated property must be used for the purpose for which it was acquired. The Commission must send utilization questionnaires to donees within six months of donating compliance items and obtain a response within one year, as required by the State Plan of Operations.

Recommendation:

The Commission should continue its efforts to ensure compliance with monitoring procedures at the Fort Worth district.

*Management's Response*:

*We concur with this recommendation. The Corrective Action Plan for this issue was released in May 1995 and implemented at that time. All utilization monitoring identified as delinquent was processed and follow-up procedures for fiscal year 1995 were completed. The General Services Commission will continue to ensure compliance with monitoring procedures at the Fort Worth district.*

## Audit Scope

The primary focus of our audit was a follow-up review of the Commission's controls over and compliance with the *Donation of Federal Surplus Personal Property* program (CFDA 39.003). Specifically, we gained an understanding of internal controls over eligibility determinations and maintenance. Specific procedures were used to test compliance with prior year issues related to the *Federal Surplus Property* program. The program received approximately $35 million of federal surplus property valued at original acquisition cost.

EXHIBIT 1:

## Status of Prior Year Issues

A material weakness in the control environment existed in fiscal year 1994 due to the number and complexity of problems identified. Since the Commission has made significant progress by resolving 8 of the 11 outstanding prior year issues, as indicated below, the control environment issue has been resolved.

Figure 2

**Status of Prior Year Issues**
***Donation of Federal Surplus Personal Property* Program**

| Issue | Unresolved | Resolved |
|---|---|---|
| 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 | |
| Comply with Federal Debarment/Suspension Requirements | | X |
| Evaluate Operating Loss | | X |
| Effectively Communicate Policies and Procedures to Employees | | X |
| Improve Computer System Maintenance Process | | X |
| Resolve Prior Automation Issues | | X |
| Enforce Subrecipient Audit Report Requirements | | X |
| Ensure Resolution of Subrecipient Audit Findings Within Required Time Frame | | X |

*The issues identified in the table above were unresolved findings from fiscal years 1991 through 1994. SAO Report Nos. 92-109, 93-048, 94-076, and 95-104, highlight the specific conditions noted in each of the past four fiscal years. This report highlights the specific conditions noted in fiscal year 1995.*

## Overall Conclusion

The Texas Department of Health (Department) is in compliance with most federal regulations related to the $4.6 billion in federal funds expended in fiscal year 1995. 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 $6.6 billion of human service expenditures, federal revenues, operating transfers in, and operating transfers out.

## Related Audit Reports

The State Auditor's Office issued a report in September 1995, titled *An Audit Report on the Analysis of Potential Overpayments Through the Medicaid Program* (SAO Report No. 96-003). The report contains recommendations which impact the Medicaid program, administered by the U.S. Department of Health and Human Services.

In February 1996, the State Auditor's Office issued a report titled *An Audit Report on Management Controls at Texas Department of Health* (SAO Report No. 96-051). The report contains recommendations which impact the overall operations of the Department including all federal grant programs administered by the U.S. Department of Health and Human Services, the U.S. Department of Agriculture, and other federal agencies.

In addition to the coverage provided by the statewide compliance audit, the State Auditor's Office is currently performing work related specifically to contract administration at certain agencies. Additional information is provided by this work, which goes beyond the federal compliance requirements covered by the statewide audit. The results of these contract administration reports include recommendations to improve the State's ability to protect public funds in areas such as fraud, waste, or inefficient use by contractors. The results for the Texas Department of Health are included in *Contract Administration At Selected Health and Human Services Agencies - Phase Three* (SAO Report No. 96-047).

## Prior Audit Issue

The Department has developed procedures to monitor spending activity to ensure that the spending thresholds for the *Maternal and Child Health Services Block Grant to the States* (CFDA 93.994) will be met. The new procedures, implemented September 1, 1995, will impact the block grant for the 1996 fiscal year.

## Federal Compliance Issues

FEDERAL COMPLIANCE ISSUE 1:

### Correctly Calculate and Report Federal Interest Liabilities

**The Department did not correctly calculate or report cash management information for fiscal years 1994 and 1995 for its four federal programs subject to Subpart A of the Cash Management Improvement Act (CMIA).** Key elements used in the cash management calculations for the programs were either incorrect or not properly supported. The Comptroller of Public Accounts uses the Department's information to calculate and report federal interest liabilities in the CMIA Annual Report. The Department's incorrect calculations resulted in inaccurate interest liabilities and payments on the CMIA Annual Report as follows:

| Federal Program | Estimated Underpayment of Interest Liability (FY 1994) | Estimated Understatement of Interest Liability (FY 1995) |
|---|---|---|
| *Medical Assistance* (CFDA 93.778) | $ 340,452 | $ 560,117 |
| *State Legalization Impact Assistance Grant (SLIAG)* (CFDA 93.565) | Not subject to Subpart A of CMIA regulations in fiscal year 1994 | Understatement not quantified |
| *Maternal and Child Health Block Grant (M&CH)* (CFDA 93.994) | Not subject to Subpart A of CMIA regulations in fiscal year 1994 | $ 142,231 |
| *Special Supplemental Food Program for Women, Infants, and Children (WIC)* (CFDA 10.557) | $ 89,019 | $ 153,227 |
| **TOTALS** | **$ 429,471** | **$ 855,575** |

The estimated underpayment of $429,471 in interest represents 29 percent of the total interest owed ($1.5 million) by the Department for fiscal year 1994. The Department's reported interest liability for fiscal year 1995 is $1.3 million, which is understated by an estimated 40 percent ($855,575). These errors constitute noncompliance, which may cause the State to undergo additional CMIA audits by the General Accounting Office or other federal agencies, or to be denied reimbursement of its administrative costs related to CMIA compliance. The administrative costs for Texas were $21,907 and $83,367 for fiscal years 1994 and 1995, respectively.

The following Department errors contributed to the incorrect calculations and inaccurate interest liabilities:

- Unsupported holding period of two days was used for both fiscal years for the *Medical Assistance* program.

- No holding period was computed or reported to the Comptroller of Public Accounts for the SLIAG program, resulting in the omission of an interest liability from the CMIA Annual Report.

- Incorrect disbursement information was used to calculate the time period federal funds were held for the M&CH program.

- Incorrect calculation methods were used for the 1994 WIC program calculations.

- Incorrect omission of 92 percent of the 1994 WIC rebates totaled $86,368,803.

The *Treasury-State Agreement, Part 7.1* sets forth the interest calculation methodology used to determine the annual interest liability for federal programs and is comprised of several components. One of the components (holding period) is a dollar-weighted calculation of the time between the deposit of federal funds in a state account and their issuance (actual release of warrants). This calculation is the direct responsibility of the Department. The responsibility for the additional calculations is shared by the Department and the Comptroller of Public Accounts. The additional calculations include a dollar-weighted calculation of the time between warrant issuance and payment clearance (actual pay-out of funds) and the calculation of federal interest liabilities, if applicable. The accuracy of the additional calculations is dependent on the correctness of information provided by the Department.

Additionally, *CMIA Policy Statement #13* states that WIC rebates may be excluded from interest liability calculations if the interest earned on the rebates is used for WIC program purposes. The Department does not use the interest earned on WIC rebates for program purposes.

Recommendation:

We recommend the Department correct all of the CMIA Annual Report errors by providing the Comptroller of Public Accounts with revised cash management information. This should result in an adjustment to the 1995 Report and the payment of the additional interest owed to the U.S. Treasury. We also recommend the Department correctly calculate and report cash management information in the future.

*Management's Response*:

***General Comments***

*The Texas Department of Health (TDH) and the Comptroller of Public Accounts (CoPA) elected to use clearance patterns in the computation of the annual interest liability related to the TDH federal programs subject to the Cash Management Improvement Act. Period one of the clearance patterns was developed by TDH and began with the deposit of federal dollars into the State Treasury and ended with the date the expenditures were posted to TDH's internal accounting records. Period two began with the TDH posting date and ended with the date the funds were actually disbursed from the State Treasury. This calculation was made by CoPA using information related to expenditure transactions supplied by TDH.*

*At issue is the fact that the agreements between Texas and the U. S. Treasury Department speak only to the use of warrant date in determining the end of period one and the beginning of period two. As a result, the State Auditor's Office (SAO) made a separate computation intended to estimate TDH's interest liability using warrant date.*

*Both TDH and CoPA agree the use of post date should be formally approved and will seek to obtain amendments to the 1994 and 1995 agreements from the U.S. Treasury which will document this approval. Given this approval can be obtained, the management of TDH is confident a part of the additional interest liability identified in this finding will be reduced.*

***Comments to Specific Findings***

1. *SAO Finding - Unsupported holding period of two days was used for both fiscal years for the Medical Assistance program.*

   *TDH Response - We disagree this holding period cannot be supported. We do agree the Treasury-State Agreement indicates a dollar-weighted calculation was to be performed and this was not done. To resolve this issue, we will ask CoPA to seek amendments to the 1994 and 1995 agreements which will document approval of our period one calculation. In the absence of such approval, we will make dollar-weighted calculations for both years and submit this information to CoPA. In either case, we are confident the additional interest liability identified in this finding will be reduced.*

2. *SAO Finding - No holding period was computed or reported to the Comptroller of Public Accounts for the SLIAG program, resulting in the omission of an interest liability from the CMIA Annual Report.*

   *TDH Response - TDH was not requested to make any calculations or submit any data related to the SLIAG program by CoPA. It is our understanding the issue of whether the SLIAG program is actually subject to the Cash Management*

*Improvement Act is in dispute and being negotiated by CoPA. Once a final determination has been reached we will comply with any additional requests for information.*

3. *SAO Finding - Incorrect disbursement information was used to calculate the time period federal funds were held for the M&CH program.*

   *TDH Response - We agree prior period disbursements were incorrectly included in our original calculation. A revised period one calculation has been made using only 1995 expenditures and CoPA will be informed so a new interest liability can be determined.*

4. *SAO Finding - Incorrect calculation methods were used for the 1994 WIC program calculations.*

   *TDH Response - Our original 1994 period one calculation for the WIC program was made in accordance with instructions provided to TDH. Subsequently, it was determined this should be a dollar-weighted calculation. As a result of this additional information, we will recalculate the period one clearance pattern for this program and submit the results to CoPA.*

5. *SAO Finding - Incorrect omission of 92% of the 1994 WIC rebates totaling $86,368,803.*

   *TDH Response - As the audit finding indicates, a federal policy statement provides for the elimination of a part of the WIC rebates in 1994 if the interest earned on these amounts were spent for WIC program purposes. Because the TDH interest liability calculation has been in question, an exact interest amount related to these rebates could not be determined. Once these uncertainties are resolved the appropriate amount will be made available for WIC program purposes or returned to the federal government in accordance with the provisions of the Cash Management Improvement Act.*

FEDERAL COMPLIANCE ISSUE 2:

## Comply with Federal Administrative Requirements Limiting Availability of Funds

**The Texas Department of Health did not comply with the federal requirements limiting the availability of funds for the payment of obligations for the *State Legalization Impact Assistance Grants* (CFDA 93.565).** The Department did not pay $2.5 million of obligations owed to local public hospitals by December 29, 1994, as specified by the requirements. An additional $5 million was paid to state medical schools after this deadline. These obligations were paid between January 5, and April 5, 1995.

We are not reporting this $7.5 million, which is otherwise supported and allowable, to be material noncompliance or questioned cost based on discussion with the federal grantor agency.

The *Code of Federal Regulations (CFR), Title 45, Chapter IV, Part 402.26* requires obligations of the SLIAG program to be paid within the time period set by *Title 45, CFR 92.23 (b)*. The time period is 90 days after the last day federal funds can be obligated

Recommendation:

We recommend that the Department comply with federal administrative requirements concerning the period of availability of funds at the conclusion of the funding period for a federal program.

*Management's Response*:

*We will continue to make every effort to comply with all federal administrative requirements.*

## Audit Scope

The primary focus of our audit was the Department's compliance with federal grant requirements. Specific procedures were used to test for compliance with federal requirements for the four major programs which represents $4.5 billion, or 98 percent, of the Department's fiscal year 1995 federal grant expenditures. We gained an understanding of the internal control structure including the general control environment, and controls over cash receipts and the payroll costs allocation process. In addition, we tested controls related to general federal compliance requirements, federal programs, and cash disbursements.

We 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 $6.6 billion of human service expenditures, federal revenues, operating transfers in, and operating transfers out.

## Overall Conclusion

The Texas Higher Education Coordinating Board (Board) has established a system that ensured compliance with significant bond covenants during fiscal year 1995. The bond schedules and bond-related "Notes to the Financial Statements" in the Board's *1995 Annual Financial Report* are materially correct and in conformity with the Comptroller's reporting requirements for annual financial reports. At August 31, 1995, the Board reported 18 outstanding bond issues, totaling $529 million.

The Board is generally complying with federal regulations regarding the *Federal Family Education Loans* program ($49 million). However, an area needing improvement includes ensuring that all loan payments are applied to loan records effective the date of receipt.

## Federal Compliance Issue

FEDERAL COMPLIANCE ISSUE 1:

### Apply Payments Effective the Date of Receipt

**The Board is not applying some borrower payments to loan records effective the date of receipt for the *Federal Family Education Loans* program (CFDA 84.032).** Borrower payments received in the afternoon mail or paid in person after 2 p.m. at the cashier's window are applied with an effective date of the next business day. For those monthly payments received in the afternoon, the borrowers are paying additional interest of one to four days to the Board. In addition, the Secretary of Education is paying the Board an additional amount associated with these outstanding loans in the form of interest benefits and special allowance payments on a quarterly basis.

*Title 34 of the Code of Federal Regulations (CFR), § 682.304,* states that the lender is to compute the total unpaid principal balance outstanding on all qualified loans on each day of the quarter. *Sections 682.300 b (2)* and *862.302 d* state that the Secretary's obligation to pay interest benefits and special allowance on a loan terminates the date the borrower's loan is repaid.

Recommendation:

The Board should apply all borrower payments to loan records effective the date of receipt. Procedures should be revised for the payments received in the afternoon mail and for payments received at the cashier's window after 2 p.m. The Board should also stamp the receipt date on all borrower payments to record the actual date of receipt.

*Management's Response*:

*The majority of payments have been applied to accounts on the day they are received. As of October 6, 1995, our procedures were changed to post all payments on the day received. Also, the identification number affixed to each payment as it is microfilmed includes the receipt date (Julian date).*

## Audit Scope

### Bonds

The primary focus of our audit was on the Board's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. At August 31, 1995, the Texas Higher Education Coordinating Board reported 18 outstanding bond issues, totaling $529 million.

We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines.

### Federal Compliance

The primary focus of our audit was on the Board's *Federal Family Education Loans* program (FFELP). We tested the administrative controls relating to the major federal programs. Specific procedures were used to test compliance with federal requirements. For fiscal year 1995, the Board reported $49 million for its *Federal Family Education Loans* program.

## Overall Conclusion

The Texas Department of Human Services (Department) is in compliance with most federal regulations related to the $4.9 billion of federal funds expended in fiscal year 1995. However, a material control weakness exists due to the Department's lack of sufficient documentation to support eligibility determinations for participation in the *Food Distribution* program.

In addition, federal revenues and human service related expenditures are accounts significant to the statewide financial statements and are materially accurate and properly reported.

## Related Reports

In addition to the coverage provided by the statewide compliance audit, the State Auditor's Office has performed work related specifically to contract administration. Additional information is provided by this work, which goes beyond the federal compliance requirements covered by the statewide audit. The results of these contract administration reports include various recommendations to improve the State's ability to protect public funds in areas such as fraud, waste, or inefficient use by contractors. Further review by the State Auditor's Office of contract administration processes is planned or in progress. The results of this work for the Texas Department of Human Services are included in *Contract Administration at Selected Health and Human Services Agencies - Phase Three* (SAO report No. 96-047).

## Internal Control Issues

INTERNAL CONTROL ISSUE 1:

### Ensure Proper Support for Food Distribution Eligibility Determinations

**Twenty-five percent of the approved applications for receipt of federal commodities lacked sufficient documentation supporting eligibility determinations**. This indicates a material weakness in the internal control structure designed to detect and prevent errors and irregularities that could be material to the program.

The *Food Distribution* program (CFDA 10.550) is responsible for distributing over $65 million in U.S. Department of Agriculture commodities to 1,743 recipient agencies such as public schools and charitable organizations. Out of 20 files reviewed, 5 had missing or incomplete forms supporting recipient agency applications or renewals.

The contract technicians at the Texas Department of Human Services (Department) review the application packets for completeness and are authorized to approve the recipient agency agreements. A final review by someone independent of the eligibility determination process could help ensure that all forms are completed.

*Title 7 of the Code of Federal Regulations (CFR) § 250.11*, requires the Department to determine the eligibility of any entity submitting an application for participation in the program. Eligible recipient agencies must have a written agreement with the Department containing the terms and conditions necessary to ensure that the distribution and use of donated food is in accordance with federal regulations.

Recommendation:

We recommend that the Department ensure that all applicable eligibility support forms are complete before recipient agencies are approved. A person independent of the review process should be responsible for the final approval of the agreement. This will help ensure that only eligible entities participate in the *Food Distribution* program.

*Management's Response*:

*The issues noted were recently identified by the Department, and specific steps have been initiated to ensure that the Department is in compliance with CFDA 10.550 and Title 7 of the CFR Section 250.11; those steps follow.*

*Of the five errors found, two were in the Food Bank area which was a new program and guidelines had not been clearly established regarding the form requirements. These guidelines were established and staff were advised of the requirements. All subsequent applications were approved based on the new requirements.*

*A need for training of the contract technicians regarding the contract approval package and the specific requirements for contract approval was identified prior to the audit. Training was scheduled; however, it was postponed due to more immediate and pressing priorities at that time. The following corrective action will be implemented immediately:*

- *Training was rescheduled for February 22, 1996, at which time each component of the contract application was explained and all requirements defined.*

- *Contract technicians within Food Distribution will be held accountable for the accurate approval of contracts. Performance plans for these positions will be rewritten by March 15, 1996, reflecting a tolerance level for accuracy of 96%.*

- *Beginning with the new contract processing year for public schools, a representative sample (10%) of contracts will be reviewed prior to approval to* *ensure accuracy. This review will be done by the lead technician and results communicated to the supervisor in a structured method.*

- *The need for additional case reading, training or other corrective action will be evaluated on an ongoing basis by management to ensure the accuracy of the program.*

*We believe the above actions will ensure an acceptable level of accuracy in the contract approval process as set forth in the Food Distribution program (CFDA 10.550) and Title 7 of the Code of Federal Regulations (CFR) § 250.11.*

INTERNAL CONTROL ISSUE 2:

## Correct Reconciling Items in a Timely Manner

(Prior Audit Issue)

**The Department has not ensured that all adjustments are posted to the accounting records in a timely manner.** While significant progress has been made in completing timely reconciliations of quarterly federal reports to the accounting records, the reconciling items identified have not been corrected in the accounting records.

Because controls to ensure timely corrections are not in place, errors could exist in the accounting records or federal reports. Such errors can affect the allocation of expenditures to the federal programs and the amount of federal funds drawn.

Regular reconciliations and timely posting of adjustments are necessary to ensure that information in federal reports and in the financial statements is accurate and complete. Additionally, these controls will help ensure accurate requests for federal funds.

Recommendation:

We recommend that the Department implement procedures to ensure that all reconciling items are corrected timely.

*Management's Response*:

*A work plan and procedures have been developed to ensure adjustments for FY 94, FY 95 and FY 96 are posted to the accounting records by August 31, 1996.*

*The following weekly management reports have been implemented and are being monitored:*

*Reconciliations Completed, Reconciliations Reviewed, Corrections Written, Corrections Entered, and Reconciling items. In addition, a schedule for reconciling items by category for each program has been created and a Master Cumulative List of reconciling items is being prepared. This function will continue to be closely monitored to ensure progress is being made to bring it to a current status by August 31, 1996.*

## Federal Compliance Issues

Recommendations addressed in the other 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 and the U.S. Department of Agriculture.

We reviewed programs totaling 95 percent of the Department's $5 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 reviewed.

FEDERAL COMPLIANCE ISSUE 1:

### Adjust Billings for Interagency Services to Actual Cost

**The Department has not adjusted billings to reflect the actual cost of providing support services to the Texas Department of Protective and Regulatory Services (TDPRS) during fiscal years 1994 and 1995.** Consequently, some federal programs may have been incorrectly charged.

In addition, the Department’s method of allocating reimbursements for support service costs resulted in incorrect charges to some federal programs. Until a methodology for allocating these costs has been agreed upon by the Department, TDPRS, and related federal agencies, the correct charges to each federal program cannot be determined.

*Office of Management and Budget (OMB) Circular A-87, Attachment C* requires that the agencies providing interagency services adjust billings to equal the actual allocable costs of the services at least annually. However, the Department’s billings are based on a predetermined contract amount. The Department billed TDPRS $33.3 million in fiscal year 1994 and $34.2 million in fiscal year 1995 (total state and federal funds) for support services.

Recommendation:

The Department should establish procedures to adjust billings for interagency services to the actual cost. The Department should coordinate with TDPRS and the U.S.

Department of Health and Human Services to determine a methodology for allocating the costs and the reimbursements associated with TDPRS-related services.

Management's Response:

*The Department will establish procedures to adjust billings for interagency services to the actual cost as recommended in the finding. Internal Audit is currently conducting an audit of the Department's Management Information Systems cost recovery methodology, including billings for interagency information systems services. Any procedures for the allocation of costs and their reimbursements will be coordinated with TDPRS and the U.S. Department of Health and Human Services.*

FEDERAL COMPLIANCE ISSUE 2:

## Ensure For-Profit Subrecipients Receive Audits

**The Department has not ensured that all for-profit subrecipients receive audits as required by federal regulations.** Out of the 209 for-profit subrecipients, 157 have not received an audit review for the past four fiscal years. Without audit coverage, the Department has no assurances that the subrecipients have spent federal funds as intended. The lack of audit coverage results in approximately $3.2 million of questioned costs for the *Child and Adult Care Food Program (CACFP)* (CFDA 10.558) for fiscal years 1992 and 1993. Additionally, $22 million provided to for-profit subrecipients in fiscal years 1994 and 1995 is at risk for not receiving appropriate audit coverage.

Figure 1

| Fiscal Year | Total Pass-Throughs and Expenditures for CFDA 10.558 | Total Pass-Throughs to For-Profit Subrecipients | Total For-Profits Not Audited | Not Audited as Percent of Total Program for CFDA 10.558 |
|---|---|---|---|---|
| 1992 | $ 84,698,863 | $ 202,383 | $ 202,383 | 0.24% |
| 1993 | $ 93,651,621 | $3,959,864 | $3,008,150 | 3.21% |
| **Total** | **$178,350,484** | **$4,162,247** | **$3,210,533** | |

Several weaknesses contribute to the lack of for-profit audit coverage. The weaknesses include:

- Contracts between the Department and for-profit subrecipients do not include specific audit requirements.

- The *CACFP* Contractor Handbook exempts for-profit subrecipients from audits.
- For-profit subrecipients are excluded from the Department's audit tracking system.
- For-profit subrecipients are omitted from the Economic Sanctioning Policy for subrecipients, which suspends contracts or places payments on hold.

*Title 7 of the Code of Federal Regulations (CFR), § 226.8*, states that for-profit institutions shall be audited by the Department at least every two years, if not subject to organization-wide audits that include compliance testing of *CACFP*.

Recommendation:

We recommend the Department correct the weaknesses to ensure that all subrecipients receive required audit coverage. This includes taking the following actions:

- Add specific audit requirements to the for-profit contracts and to the *CACFP* Handbook.
- Include for-profit subrecipients in the current tracking system and the Economic Sanctioning Policy.
- Audit for-profit entities every two years if independent audits do not include compliance testing of *CACFP*.

*Management's Response*:

*Special Nutrition Program Contracts and Handbooks will be updated to specify audit requirements for for-profit contractors. For-profit contractors will be tracked in the current tracking system. The Economic Sanctioning Policy will be revised to include for-profit contractors.*

*We agree that federal regulations require for-profit recipients receiving more than $25,000 receive audits. Risk analysis and staffing limitations have limited our audits to those for-profit recipients receiving over $50,000. We will therefore ask USDA for a waiver to raise the threshold.*

FEDERAL COMPLIANCE ISSUE 3:

## Ensure Accuracy of Subrecipient Tracking Information

(Prior Audit Issue)

**The Department's subrecipient monitoring tracking system does not accurately determine or record "audit due dates."** Inaccurate information in the tracking system could result in delinquent audit reports. Delinquent audit reports prevent the Department from monitoring their subrecipients and result in questioned costs.

The tracking system automatically designates an audit due date (annual or biennial) based on the dollar amount of the federal assistance. The federal requirement for independent audits and their frequency is not based solely on the dollar amount of federal assistance. The required frequency of audits varies depending on the type of entity receiving $25,000 or more in federal assistance. State and local governments are required to submit annual audits. Not-for-profit entities are allowed to submit biennial *Office of Management and Budget (OMB) A-133* audits, if their financial audit is performed in the same time frame.

This issue affects the following programs: *Food Distribution* (CFDA 10.550), *School Breakfast/Lunch* (CFDA 10.553/10.555), *Child and Adult Care Food* (CFDA 10.558), *Summer Food Service Program for Children* (CFDA 10.559), *Temporary Emergency Food Assistance - Administrative/Commodities* (CFDA 10.568/10.569), and *Food Commodities for Soup Kitchens* (CFDA 10.571).

Recommendation:

We recommend the Department correct the tracking determination and recording of "audit due dates" to ensure timely receipt and review of audit reports.

*Management's Response*:

*The Department's subrecipient monitoring tracking system is being corrected to accurately determine "audit due dates." It is a manual process whereas the contractor's fiscal year end is manually keyed into the tracking system from Form 1569. For FY 95 all of the contractors' year ends will come from the Form 1569, and if left blank or conflicts with previous data, the contractor will be called for verification.*

*Programming of the tracking system was corrected to code governmentals as annual audits unless they were exempt.*

*An additional statement has been included on the newly revised Form 1569:*

*"**_____ An Annual _______ A Biennial** audit as a condition of eligibility to participate in the Special Nutrition Programs, and that failure to do so as required could result in adverse action, including the withholding of my claim for reimbursement payments and termination of my contract. I also understand that if I am a private non-profit organization subject to the requirements of the Single Audit Act and have a financial audit performed annually, I must also obtain a single audit on an annual basis."*

FEDERAL COMPLIANCE ISSUE 4:

## Limit Subrecipient Cash Advances to Cash Needs

**The Department does not limit subrecipient cash advances to immediate cash needs for the *Child and Adult Care Food Program* (CFDA 10.558).** In addition, the Department is not following its procedures for deducting excess cash advances from subsequent subrecipient payments. This results in noncompliance with federal cash management requirements.

The Nutrition Automated Payment Processing (NAPP) system processes administrative advances based solely on the prior month's actual expenditures. Subrecipients submitting late claims also contribute to the excess cash advances.

Recommendation:

We recommend the Department limit subrecipient cash advances to immediate cash needs. The Department should follow its procedures for deducting excess cash advances from subsequent subrecipient payments.

*Management's Response*:

*The Department agrees with this finding. However, two points need to be noted. The regulations give a subrecipient as much as 90 days use of the funds without submitting a claim. The Department does adjust subsequent claim payments based on advances received.*

*The Department has initiated a corrective action plan to do the following by the end of State Fiscal Year 1996:*

*If a subrecipient fails to submit a claim by the regulatory deadline, a claim of zero will be entered in NAPP. That month's advance will then be put into the advance carry over and recouped from the next claim submitted by the subrecipient. If a late claim is subsequently approved for payment it will be entered as an amended claim.*

*Future advances will be suspended until a subrecipient has paid up prior fiscal year outstanding advances.*

*Full advances of 100% and partial advances of 50% will be redefined as 80% and 40% respectively.*

*Contractors will be aggressively encouraged to take the shortest time possible to pay back advances.*

*Subrecipients, especially centers, will be encouraged to take partial or no advances during the summer when they know attendance will be down.*

FEDERAL COMPLIANCE ISSUE 5:

## Do Not Charge Federal Programs for Settlements of Lawsuits

**The Department used federal funds to pay for settlements of lawsuits in which the Department allegedly violated federal and state laws and regulations.** As a result, unallowable costs totaling $165,649 were charged to the following federal programs in fiscal year 1995:

Figure 2

| CFDA # | Description | FY 95 Questioned Costs |
|---|---|---|
| 10.559 | *Summer Food Service Program for Children* | $ 25 |
| 10.560 | *State Administrative Expenses for Child Nutrition* | 633 |
| 10.561 | *State Administrative Matching Grants for Food Stamp Program* | 62,453 |
| 93.556 | *Family Preservation and Support Services* | 500 |
| 93.560 | *Family Support Payments to States- Assistance Payments* | 22,580 |
| 93.561 | *Job Opportunities and Basic Skills Training* | 3,295 |
| 93.566 | *Refugee and Entrant Assistance - State Administered Programs* | 79 |
| 93.574 | *Child Care for Families At-Risk of Welfare Dependency* | 51 |
| 93.575 | *Child Care and Development Block Grant* | 5,575 |
| 93.645 | *Child Welfare Services - State Grants* | 13 |
| 93.658 | *Foster Care - Title IV-E* | 529 |
| 93.659 | *Adoption Assistance* | 220 |
| 93.667 | *Social Services Block Grant* | 320 |
| 93.777 | *State Survey and Certification of Health Care Providers and Suppliers* | 5,391 |
| 93.778 | *Medical Assistance Program* | 63,985 |
| | **Total** | **$165,649** |

*The Office of Management and Budget (OMB) Circular A-87* prohibits the use of federal funds for settlements resulting from violations (or alleged violations) of federal, state, or local laws and regulations. These cases were settled prior to a court ruling and do not constitute an admission of guilt by the Department. The basis of allegations brought forth against the Department, however, are sufficient to prohibit the use of federal funds for the resulting settlement.

Recommendation:

The Department should not charge federal programs for the settlement of lawsuits and should return the questioned costs totaling $165,649 to the federal grantor agencies.

*Management's Response*:

*The Department is analyzing the questioned costs for the settlement of lawsuits, and when the analysis is complete will return all unallowable costs to the appropriate federal grantor agencies.*

## Audit Scope

The primary focus of our audit was the Department's financial and administrative controls over federal programs. We gained an understanding of the internal control structure, including the general control environment, and tested controls related to major federal programs, cash disbursements, the cost allocation system, and food stamp electronic benefit transfers. 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 federal revenues and human services expenditures.

## Overall Conclusion

Lamar University - Beaumont is generally complying with the significant bond covenants of its outstanding bond issues. However, the University should continue its efforts to improve Housing System operations and eliminate its operating deficits. The fiscal year 1995 operating deficit was $35,000, whereas the operating deficit was $4,000 in fiscal year 1994.

In addition, the bond information for the University as reported in the State's *1995 Comprehensive Annual Financial Report* is materially correct. At August 31, 1995, the University reported 11 outstanding bond issues, totaling $18.6 million.

## Bond Compliance Issue

### Continue Efforts to Improve Housing System Operations and Eliminate the Operating Deficits

**Lamar University-Beaumont's Housing System revenues were not sufficient to pay both the Housing System operating expenses and the principal and interest requirements of the Housing System bonds**. This resulted in a $35,000 operating deficit for fiscal year 1995, whereas the operating deficit in fiscal year 1994 was $4,000. The University's ability to meet future debt service requirements could be impaired if this deficit is not eliminated.

The current operating deficit is greater than in the prior year because Housing System revenues decreased by 1.3 percent in fiscal year 1995. However, management should be commended for minimizing the decrease in Housing revenues, in light of the six percent decrease in University enrollment.

Management is monitoring Housing System operations on a monthly basis and periodically reviews progress in eliminating the deficit. In addition, management has responded to student requests for making improvements to the Housing System and has taken actions to increase enrollment and the on-campus housing occupancy.

<u>Recommendation</u>:

Management should continue its efforts to improve Housing System operations and eliminate the operating deficits. This will ensure that both the Housing System operating expenses and the future debt service requirements on the Housing System bonds will be met. These efforts have already reduced the operating deficit from a high of $524,000 in fiscal year 1993 to the current level.

*Management's Response*:

*Management concurs with the audit recommendation and is fully committed to a continuation of efforts to reduce and ultimately eliminate the operating deficits. Management acknowledges and appreciates the State Auditor's Office recognition of University efforts and accomplishments to this end.*

## Audit Scope

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported 11 outstanding bond issues, totaling $18.6 million.

## Overall Conclusion

Our audits continue to indicate that the Texas Department of Protective and Regulatory Services (Department) is not complying with all federal requirements for two of its federal programs. Expenditures for these programs total $127.5 million and represent 40 percent of total federal funds expended by the Department in fiscal year 1995. Material noncompliance for the *Child Welfare Services - State Grants* program has occurred for the third consecutive year.

## Other Related Reports

In addition to the coverage provided by the statewide compliance audit, the State Auditor's Office has performed work specifically related to contract administration. Additional information is provided by this work, which goes beyond the federal compliance requirements covered by the statewide audit. The results of these contract administration reports include various recommendations to improve the State's ability to protect public funds in areas such as fraud, waste, or inefficient use by contractors. The results for the Department are included in *Contract Administration at Selected Health and Human Services Agencies - Phase Three* (SAO Report No. 96-047). Further review by the State Auditor's Office of contract administration processes is planned or in progress, which will include the Department.

The U.S. Department of Health and Human Services' Office of Inspector General issued two reports (Report # A-06-94-00041 and # A-06-95-00035) with findings related to the improper retaining of federal funds by Child Placing Agencies and the Department's monitoring of these agencies. The Department contracts with Child Placing Agencies to provide services under the *Foster Care - Title IV-E* program.

Additionally, the Texas Department of Human Services' Internal Audit Division released reports (# 95-101 and # 95-011) with findings pertaining to the Department's Child Protective Services bookkeeping functions and activities. These findings impact the *Foster Care - Title IV-E* program.

The effect of the exceptions and issues identified in these reports was considered in our fiscal year 1995 audit plan for the Department.

## Federal Compliance Issues

Recommendations addressed in the Accounting and Reporting issues 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 ISSUE 1:

## Ensure That Payments Are Made for Appropriately Documented Clients and Costs

(Prior Audit Issue)

**The Texas Department of Protective and Regulatory Services (Department) is in material noncompliance with the federal eligibility and allowable cost requirements for the *Child Welfare Services - State Grants* program (CFDA 93.645)**. The Department paid $7,504 for purchased services provided to 11 clients without sufficient documentation showing that the clients were eligible for these services.

Out of 45 *Child Welfare Services* clients tested, 11 errors were noted totaling $2,174. This represented 29.2 percent of the $7,443 tested. An error rate of five percent or more is considered material noncompliance. The $7,504 in questioned costs represents all related payments to these clients for the fiscal year ended August 31, 1995.

The Department uses *Child Welfare Services* funds to prevent child abuse and ensure the safety of abused children. The $20.1 million spent on this program in fiscal year 1995 included payments for psychological evaluation and testing, homemaker services, 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. Eleven of the 45 clients tested received services for which eligibility was not documented under the *Child Welfare Services - State Grants* program.

Recommendation:

The Department should 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 the services are properly authorized and that the need for services is properly documented.

*Management's Response*:

*The Department agrees with the recommendation. Prior efforts to address this finding through memos to staff and through focused training have not resolved this audit finding. Consequently, the Department will implement a statewide program of monthly sampling of Child Welfare Services expenditures to verify that all services are properly authorized and documented. Beginning in February 1996, sample payments will be selected by staff of the Office of Contract Administration. Contract Administration staff will then request copies of supporting documentation from the regional staff responsible for authorizing services. The Deputy Director for*

*Protective Services for Families and Children will be responsible for implementing a process to ensure compliance for any errors identified by the sample. Unauthorized payments will be recouped. Effective September 1, 1996 the Child and Adult Protective Services System (CAPS) will require a service authorization prior to payment which should essentially eliminate this problem.*

FEDERAL COMPLIANCE ISSUE 2:

## Ensure Interagency Support Services Costs Are Correctly Charged to Federal Programs

**The Department incorrectly charged federal programs for costs incurred for support services provided by the Texas Department of Human Services (TDHS)**. The Department did not ensure that reimbursements to TDHS for support services were based on the actual cost of services provided by TDHS in fiscal years 1994 and 1995. Additionally, the Department charged its federal programs at different amounts than were originally charged by TDHS. Until a methodology for allocating these costs has been agreed upon by the Department, TDHS, and related federal agencies, the correct charges to each federal program cannot be determined.

*Office of Management and Budget (OMB) Circular A-87, Attachment A*, states that the cost of services provided by one agency to another should only include the actual allocable costs. However, the amount paid by the Department was based on a predetermined contract amount. In fiscal years 1994 and 1995, the Department reimbursed TDHS $33.3 million and $34.2 million (total state and federal funds), respectively, for support services.

Recommendation:

We recommend that the Department ensure that interagency support services costs are correctly charged to federal programs. TDHS billings, which are based on estimates, should be adjusted to actual allocable costs. It will be up to the discretion of the applicable federal agencies to determine if the Department should perform these calculations and adjustments for fiscal years 1994 and 1995. Additionally, the Department should coordinate with TDHS and the U.S. Department of Health and Human Services to determine a methodology for allocating the costs associated with these support services.

*Management's Response*:

*The Department recognizes that different cost allocation methodologies between the Department and TDHS caused the federal programs to be charged at different amounts. The Department is working with TDHS in fiscal year 1996 to implement changes in reimbursement and claiming methodologies with the goal of eliminating* *the differences between agencies. The Department will continue its efforts by coordinating with TDHS and the U.S. Department of Health and Human Services to determine a methodology for allocating shared location, support services, and pooled overhead costs that is acceptable to the U.S. Department of Health and Human Services.*

FEDERAL COMPLIANCE ISSUE 3:

## Limit Title IV-E Maintenance Claims to Allowable Costs

**The Department incorrectly charged the *Foster Care - Title IV-E* program (CFDA 93.658) for an estimated $2.9 million in foster care maintenance costs that are not allowable costs under the program**.

The overcharge is a result of a programming error that occurred when modifications were made to the foster care payment system. The error remained undetected for approximately four months before programming corrections were made.

*Office of Management and Budget (OMB) Circular A-87* requires that the costs charged to a federal program conform to the specific limitations and exclusions of the program regulations.

Recommendation:

The Department should ensure that the *Foster Care - Title IV-E* program is charged for only the allowable portion of the foster care maintenance costs. Additionally, the Department should calculate the actual amount of the questioned costs and return these funds to the Federal Government.

*Management's Response*:

*The Department concurs that the Title IV-E program was incorrectly charged for foster care maintenance costs. We will be reallocating the costs for all payments relating to foster care including costs associated with Titles IV-E, IV-A, and XIX. This reallocation will correct the unallowable charges to Title IV-E and should be complete by the end of the fiscal year.*

FEDERAL COMPLIANCE ISSUE 4:

## Do Not Charge Federal Programs for Settlements of Lawsuits

**The Department used federal funds to pay for settlements of lawsuits in which the Department allegedly violated federal and state laws and regulations.** As a result, unallowable costs totaling $149,342 were charged to the following federal programs in fiscal year 1995:

| CFDA # | Description | FY 95 Questioned Costs |
|---|---|---|
| 93.560 | *Family Support Payments to States - Assistance Payments* | $ 36,143 |
| 93.658 | *Foster Care - Title IV-E* | 7,990 |
| 93.659 | *Adoption Assistance* | 3,915 |
| 93.667 | *Social Services Block Grant* | 51,660 |
| 93.778 | *Medical Assistance Program* | 49,634 |
| | **Total** | $149,342 |

*The Office of Management and Budget (OMB) Circular A-87* prohibits the use of federal funds for settlements resulting from violations (or alleged violations) of federal, state, or local laws and regulations. These cases were settled prior to a court ruling, and do not constitute an admission of guilt by the Department. The basis of allegations brought forth against the Department, however, are sufficient to prohibit the use of federal funds for the resulting settlement.

Recommendation:

The Department should not charge federal programs for unallowable costs incurred in the settlement of lawsuits and should return the questioned costs totaling $149,342 to the federal grantor agencies.

*Management's Response*:

*The Department will return the questioned costs to the appropriate federal programs and will coordinate with the Department of Human Services to correct the system to prevent charges of this nature in the future.*

FEDERAL COMPLIANCE ISSUE 5:

## Comply with Federal Debarment/Suspension Requirements

**The Department did not comply with federal debarment and suspension requirements**. Seventy percent (7 out of 10) of the Department's *Foster Care - Title IV-E* program contracts tested did not contain debarment and suspension certifications.

These seven errors affect $996,200 or approximately 70 percent of the $1,432,071 tested. A 70 percent error rate would normally constitute material noncompliance. However, based on discussions with the federal grantor agency, we will not consider this issue to be material noncompliance, nor will the associated costs be questioned.

*Title 45 of the Code of Federal Regulations (CFR), Part 76*, requires the Department to obtain certifications from contractors that they are not debarred or suspended from participating in federal assistance programs.

Recommendation:

The Department should comply with debarment and suspension requirements by preventing *Foster Care - Title IV-E* contractors, who do not submit debarment and suspension certifications, from participating in the program.

*Management's Response*:

*The Department has revised and updated its foster care contract document to include the federally required assurances relating to suspension and debarment. The new contract will be effective by September 1, 1996.*

## Accounting and Reporting Issues

ACCOUNTING AND REPORTING ISSUE 1:

### Correct Reconciling Items in a Timely Manner

(Prior Audit Issue)

**The Department has not ensured that all adjustments are posted to the accounting records in a timely manner**. Significant progress has been made in completing timely reconciliations of quarterly federal reports to the accounting records. However, the reconciling items identified have not been corrected in the accounting records.

Because controls to ensure timely corrections are not in place, errors could exist in the accounting records or federal reports. Such errors can affect the allocation of expenditures to the federal programs and the amount of federal funds drawn.

Although the Department contracts with the Texas Department of Human Services (TDHS) 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. Additionally, these controls will help ensure accurate requests for federal funds.

Recommendation:

We recommend that the Department more closely monitor its contracted accounting services. Specifically, the Department should implement procedures to verify that all reconciling items are corrected in a timely manner.

*Management's Response*:

*DHS processes all of the Department's reconciling items so our control is somewhat limited, but we recognize the need to monitor and review the services under contract with DHS on a regular basis. We will work with DHS to implement the following procedures to verify that reconciling items are corrected timely:*

- *The Department's staff will sign off on reconciling items as they are identified.*
- *The Department will recommend that all adjustments be posted to the system within 30 days.*
- *The Department will sign off on the posting of adjustments after they have been entered into the accounting system.*

ACCOUNTING AND REPORTING ISSUE 2:

## Ensure the Accuracy of Financial Reports

**The Department's annual financial report and related Schedule of Federal Financial Assistance are not accurate**. Federal revenue and related expenditures for the *Adoption Assistance* program (CFDA 93.659) were overstated by approximately $4.8 million.

The error occurred because an adjustment to the accounting records was not posted for approximately six months. Consequently, the adjustment was posted to the incorrect fiscal year.

Errors in reporting may cause the users of the financial information to make decisions based on inaccurate data. Additionally, delays in posting adjustments can result in inaccurate requests for federal funds.

Recommendation:

We recommend that the Department help ensure the accuracy of financial reports through timely posting of adjustments to the accounting records.

*Management's Response*:

*As noted in our response to the finding "Correct Reconciling Items Timely," the Department concurs that the timeliness of all adjustments have an impact on the federal reports and financial statements, consequently affecting the allocation of expenditures to federal programs and the amount of federal funds drawn. The Department will work with DHS to ensure that adjustments are posted to the system within 30 days. If adjustments are made after the fiscal year end, we will notify the Annual Financial Report section for inclusion in our financial statements.*

## Audit Scope

The primary focus of our audit was the Department's financial and administrative controls over two of its major federal programs relating to the State's child and adult protective services. These two programs, *Foster Care* - *Title IV-E* and *Child Welfare Services* - *State Grants*, had expenditures of approximately $127.5 million for fiscal year 1995. 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 these two major federal programs. Additionally, we performed limited audit procedures in relation to one non-major program, *Adoption Assistance*.

## Overall Conclusion

Texas A&M University System (System) has established a system that ensured compliance with significant bond covenants during fiscal year 1995. The bond schedules and bond-related "Notes to the Financial Statements" in the System's *1995 Annual Financial Report* are materially correct and in conformity with the Comptroller's reporting requirements for annual financial reports. At August 31, 1995, Texas A&M University System reported 22 outstanding bond issues, totaling $726 million.

Texas A&M University is generally complying with federal regulations regarding the *Federal Family Education Loans* program ($57.7 million) and the *Federal Pell Grant Program* ($8.4 million) for student financial assistance. However, areas needing improvement include delaying disbursements to first-time borrowers and disbursing loans at prescribed times. In addition, the University should implement procedures to ensure that timely exit counseling information is provided and that all enrollment changes are reported to the guarantor or lender in a timely manner.

## Federal Compliance Issues

FEDERAL COMPLIANCE ISSUE 1:

### Delay Disbursements to First-Time Borrowers

**The University did not delay the initial disbursement of *Federal Family Education Loans (FFELP)* (CFDA 84.032) payments to all first-time, first-year borrowers.** Disbursements were not delayed for the required 30 days in 12 percent (3 of 25) of the student files tested. Failure to properly delay disbursements to first-time borrowers could result in the distribution of loan funds to ineligible borrowers.

*Title 34 of the Code of Federal Regulations (CFR), § 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 loan, not be released until 30 days after the first class day.

Recommendation:

We recommend that the University delay the initial disbursements to all first-time, first-year borrowers for the required 30 days after the first class day.

*Management's Response*:

*Currently first-time, first-year borrowers are manually identified during the loan certification process. To identify accurately all the first-time, first-year borrowers, we will automate the identification process at the time the financial aid award is made.*

*When the student financial aid package includes a loan, our Student Information Management System (SIMS) will automatically establish the disbursement date compliant with CFR 682.604. This disbursement date will be posted to the loan certification screen of SIMS and preprinted on the Stafford Loan Application/Promissory Note. This new procedure will help ensure that initial disbursements to all first-time, first-year borrowers will be delayed the required thirty days after the first class day.*

FEDERAL COMPLIANCE ISSUE 2:

## Disburse Loan Payments at Prescribed Times

**The University did not disburse all *Federal Family Education Loans* program (CFDA 84.032) payments according to federally prescribed time frames.** The student accounts for medical and veterinary students were credited earlier than three weeks before the first day of classes for the spring semester.

*Title 34 of the Code of Federal Regulations (CFR), § 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 Family Education Loans* program payments to students at prescribed times. Procedures should be revised to ensure that all student accounts are not credited more than three weeks before the first class day.

*Management's Response*:

*The 1995-96 disbursement and release dates are compliant with the new Federal Cash Management Regulations that became effective July 1, 1995. To ensure proper disbursement, edits will be developed within SIMS to prevent the early release of loan funds.*

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 Loans* program (CFDA 84.032).** Timely exit counseling information was not provided for 12 percent (3 of 25) of the student files tested. Two files did not contain any exit counseling documentation, while the documentation in one file showed exit counseling was not provided in a timely manner. Inadequate exit counseling procedures could result in an increased loan default rate.

*Title 34 of the Code of Federal Regulations (CFR), § 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.

<u>Recommendation</u>:

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.

*<u>Management's Response</u>*:

*Exit counseling will be performed when a student ceases to be enrolled at least half-time. A report will be developed and produced at least biweekly, identifying students who dropped below half-time, but are still enrolled. Exit counseling will be provided to these students. Also, students that withdraw or graduate from the university are currently receiving information on exit counseling and this procedure will continue. The current policy regarding non-attendance of a counseling session will be expanded to included those students who drop below half-time, but are still enrolled. Students that do not attend an exit counseling session within thirty days will be sent exit information and their University records will be blocked until the exit form is returned. Appropriate documentation will be maintained in the student's file.*

FEDERAL COMPLIANCE ISSUE 4:

## Report Enrollment Changes in a Timely Manner

**The University is not reporting all enrollment changes for the *Federal Family Education Loans* program (CFDA 84.032) within the required time frames.** Enrollment changes occur when a student graduates, withdraws, drops classes, 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. In addition, procedures for reporting to guarantors, other than Texas Guaranteed Student Loan Corporation, are not sufficient to ensure that enrollment changes are reported within the required time frames.

*Title 34 of the Code of Federal Regulations (CFR), § 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. In addition, procedures for reporting enrollment changes to guarantors, other than the Texas Guaranteed Student Loan Corporation, should be strengthened to ensure that enrollment changes are reported within the required time frames.

*Management's Response*:

*A report will be developed and produced at least biweekly to identify all enrollment changes. The report will be used to determine the changes that will not be reported within sixty days on a Student Status Confirmation Report (SSCR). A letter will be sent to the appropriate lender or guaranty agency within thirty days for students whose enrollment changes will not be reported on an SSCR. This procedure will be used until the SSCR portion of the Department of Education's National Student Loan Data System is implemented.*

## Audit Scope

### Texas A&M University System

The primary focus of our audit was on the System's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. At August 31, 1995, Texas A&M University System reported 22 outstanding bond issues, totaling $726 million.

We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines.

### Texas A&M University

The primary focus of our audit was on the University's two largest student financial assistance programs: the *Federal Family Education Loans* 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. For fiscal year 1995, the total dollar value of the programs at the University are as follows:

| | |
|---|---|
| *Federal Pell Grant Program* | $ 8,365,668 |
| *Federal Family Education Loans* program | $57,697,507 |

## Overall Conclusion

Texas Southern University (University) is not adequately administering the *Federal Family Education Loans* and *Federal Pell Grant* programs, which have combined expenditures of over $41.5 million. The multitude and magnitude of the problems identified indicate that the material weakness in the control environment of the Student Financial Assistance Office, originally identified in fiscal year 1993, still exists. During this audit, 22 issues were identified, 14 of which were significant enough to be included in this report. This noncompliance with federal regulations resulted in unduplicated questioned costs totaling $210,142. Texas Southern University's continued participation in federal financial assistance programs may be at risk, due to the material weakness in the control environment and other unresolved compliance issues. This could impact 75.4 percent of the University's total enrollment, since this portion of the student population receives federal financial assistance.

The University has established a system that ensured compliance with significant bond covenants during fiscal year 1995. The bond schedules and bond-related "Notes to the Financial Statements" in the University's *1995 Annual Financial Report* are materially correct and in conformity with the Comptroller's reporting requirements for annual financial reports. At August 31, 1995, Texas Southern University reported two outstanding bond issues, totaling $20 million.

## Prior Audit Issues

In September 1995, the U.S. Department of Education (ED) issued its final audit determination letter (Audit Control No. 06-43703) identifying a total liability of $13,603,625 due from Texas Southern University. The University is currently in the process of negotiating this liability amount with ED. This final audit determination letter relates to our report titled *Financial and Compliance Audit Results - State of Texas* (SAO Report No. 94-105) for fiscal year 1993. None of the ten issues that were significant enough to be reported in fiscal year 1993 have been resolved. In addition, eight of these issues, including the six comprising the $13 million liability amount, are repeated in this report.

## Other Related Investigations

The U.S. Department of Education (ED) Regional Inspector General and the Federal Bureau of Investigation (FBI) are still conducting a joint investigation, mentioned in our fiscal year 1993 report. This investigation relates to indications of possible fraud and misapplication of federal funds at Texas Southern University. During this audit, additional indications of possible fraud and misapplication of federal funds were discovered, and this information has been provided to ED and the FBI.

## Internal Control Issues

INTERNAL CONTROL ISSUE 1:

### Strengthen the Control Environment of Student Financial Assistance Office

(Prior Audit Issue)

**The material weakness in the control environment of the Student Financial Assistance (SFA) Office, originally identified during the 1993 SFA audit, still exists.** Ineffective personnel practices, ineffective policies and procedures, and the lack of coordination between departments are all contributing factors to the control environment material weakness. The control environment reflects the overall attitudes, awareness, and actions of management concerning the importance of and its emphasis on controls. A material weakness in the control environment means that conditions exist that would allow unintentional mistakes and intentional improprieties to occur and go undetected within the department.

The factors contributing to the material weakness in the control environment are discussed in detail below:

**Ineffective Personnel Practices** - Since June 1994, there has been an interim SFA director, who had not previously worked in the financial assistance area. In addition, the assistant director position has been vacant since January 1994. Furthermore, current job descriptions were not available for the directors of the central SFA office and the law school SFA office. The staff in the central SFA office also indicated that they did not know their current titles and responsibilities or their office's organization/ structure. Lastly, SFA personnel, including the interim director, received very minimal training during calendar year 1994 and have not received any training as of October 1995 for the 1995 calendar year.

**Ineffective Policies and Procedures** - Although a policy and procedure manual was finally completed on August 31, 1995, this manual has not been reviewed or distributed to SFA staff. In addition, during our audit we noted inconsistencies between staff on implementation of the satisfactory academic progress policy. There was also evidence of management override of controls.

**Lack of Coordination Between Departments** - A lack of coordination and communication exits between the SFA office and the University's administrative offices. The Student Status Confirmation Reports (SSCRs) were not always completed accurately or returned to the guarantor. This is a result of the Registrar's Office not forwarding all SSCRs to the SFA office to be completed and not entering some graduation dates on the automated system. In addition, the university personnel did not seem clear about who performs the functions related to refunds.

*Title 34 of the Code of Federal Regulations (CFR), § 668.14,* states that for an institution to continue to participate in any federal financial assistance programs, the institution must demonstrate it is capable of administering the federal programs. A strong control environment within the department is essential to ensure that the financial assistance 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 Assistance Office in order to eliminate the material weakness.

- To enhance the effectiveness of its personnel practices and policies, the University should evaluate the effectiveness of the high-level positions of the SFA director and assistant director being interim and vacant for an extended period of time. The University should also ensure that current job descriptions exist, and that all the SFA personnel are aware of their individual job titles and responsibilities, and are informed of the office's organization. Furthermore, all SFA personnel should be provided with adequate training.

- To improve the effectiveness of its SFA policies and procedures, the new SFA manual should be reviewed, and revised if necessary, to ensure that the policies and procedures are accurate. The approved SFA manual should then be distributed to all staff members and consistent implementation of the policies and procedures enforced. Furthermore, controls should be implemented that prohibit management override.

- To eliminate the lack of coordination between departments, the University should develop written policies and procedures that address the necessary coordination between the SFA office and other administrative offices. These policies and procedures should clearly designate the responsibilities for each department.

*Management's Response*:

*We concur with these recommendations. The necessary actions to implement these recommendations will begin immediately and will be completed by March 1, 1996. At this time, all job descriptions are available and we have reviewed changes in the responsibilities and/or titles with individual staff members, as part of the reorganization. Funds have been allocated for staff training and plans for internal unit training are in place for the Spring semester.*

*The SFA manual of policies and procedures will be disseminated to SFA staff by February 1, 1996.*

*Strict policy will be enforced to ensure no practices of management override will exist in areas that prohibit professional judgement. Staff will be advised of this policy and will be encouraged to report any such incidents.*

*Policies and procedures for all steps in the financial aid process (no matter what functional office performs the steps) will be developed, coordinated with all functional units and monitored for performance.*

INTERNAL CONTROL ISSUE 2:

### Strengthen Controls over Receipt of Law Access Loans Proceeds

(Prior Audit Issue)

**The University's Student Financial Assistance (SFA) Office should strengthen controls over the receipt of Law Access loan proceeds for the *Federal Family Education Loans* program (CFDA 84.032).** Although the central SFA office loan checks are now received in the Fiscal Office, the law school SFA office is currently receiving the loan proceeds for law students. Since all functions for the law school financial aid office are performed by one individual, this increases the risk of unauthorized loans being processed and the proceeds retained without being detected.

*Title 34 of the Code of Federal Regulations (CFR), § 668.16(c)*, requires an institution to ensure that its procedures for administrating the Student Financial Aid programs include an adequate system of internal checks and balances.

Recommendation:

We recommend that the University strengthen controls over the receipt of Law Access loans proceeds. This can be accomplished by having these loan proceeds delivered directly to the Fiscal Office.

*Management's Response*:

*Management concurs with this recommendation, and beginning immediately will instruct all lenders to mail or deliver all loan proceeds directly to the Fiscal Office.*

## Federal Compliance Issues

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

FEDERAL COMPLIANCE ISSUE 1:

## Ensure That All Students Are Maintaining Satisfactory Academic Progress

(Prior Audit Issue)

**The University is not ensuring that all recipients of the *Federal Pell Grant Program* (CFDA 84.063), *Federal Family Education Loans* program (CFDA 84.032), and other federal financial assistance programs are maintaining satisfactory academic progress.** For 9 of the 80 (11.3 percent) files tested, the students were not maintaining satisfactory academic progress. This resulted in questioned costs of $82,798.18.

These exceptions occurred because, the University has not been monitoring the students' completion rates, as outlined in its satisfactory academic progress policy. Not monitoring the completion rate enables students to continue receiving financial aid even though they have not completed the required number of hours.

*Title 34 of the Code of Federal Regulations (CFR), § 668.16(e)(3),* states that an institution must determine at the end of each increment whether the student has successfully completed the appropriate percentage or amount of work according to its established schedule.

Recommendation:

We recommend the University ensure that all recipients of the *Federal Pell Grant Program, Federal Family Education Loans* program, and other federal financial assistance programs are maintaining satisfactory progress. The University should monitor the completion rates for all students according to its satisfactory academic progress policy. In addition, total questioned costs of $82,798.18 should be returned to the federal financial assistance programs.

*Management's Response*:

*The University acknowledges that an incorrect algorithm was used for determining the percentage of completion portion of the Satisfactory Academic Progress criteria for awarding financial aid. The University is committed to ensuring that all formulas used to calculate Satisfactory Academic Progress (both GPA and percentage of completion) will be in compliance with appropriate regulations by January 2, 1996.*

*Because of a computer system limitation prior to September 1, 1995, which did not include "W" and "I" grades in the percentage of completion calculation, the University will request a waiver of the questioned costs of $82,798.18 from the Department of Education.*

FEDERAL COMPLIANCE ISSUE 2:

## Ensure That All Recipients Submit a Completed Student Aid Report

**The University is not ensuring that all recipients of the *Federal Pell Grant Program* (CFDA 84.063) and the *Federal Family Education Loans* program (CFDA 84.032) submit a completed Student Aid Report (SAR).** Not obtaining complete information could result in disbursing aid to ineligible students or disbursing aid in excess of a student's eligibility.

In 3 of 80 (four percent) files tested, the students had not signed all of the required statements on the SAR, resulting in questioned costs of $23,775. In addition, 4 of the 41 (ten percent) files tested for SAR verification did not contain the required Institutional Verification Form (IVF), which is used to verify the number of family members in the household. This resulted in questioned costs of $35,824.

*Title 34 of the Code of Federal Regulations (CFR), §§ 668.32, 668.7, 668.33,* and *668.55(b)(2),* requires a student to sign a Statement of Educational Purpose/ Certification Statement on Refunds and Default, a Statement of Registration Status, and a Statement of Updated Information. *Section 668.57(b)* states that an institution shall require an applicant selected for verification to verify the number of family members by submitting a signed statement listing the name and age of each family member and his/her relationship to the applicant.

<u>Recommendation</u>:

We recommend the University ensure that all recipients submit a completed Student Aid Report. Procedures should be developed to ensure that students sign all the required statements and that an IVF is obtained for all students who have been selected for verification. In addition, total questioned costs of $59,599 should be returned to the federal financial assistance programs.

*<u>Management's Response</u>*:

*The University acknowledges the completed Student Aid Reports (SAR) were not included in the indicated files at the time of awarding of financial aid or the audit; however, signed SAR's have been requested from the three students and will be included in their files when received. In addition, the four students who had not submitted signed Institutional Verification Forms (IVF) have been asked to do so. These will be included in the students' folders as received. Upon receipt of all documents, the University will request a waiver of the questioned costs of $35,824 for the IVFs and $23,775 for the SARs from the Department of Education.*

*Effectively immediately, the document intake and student counseling functions have been reorganized to ensure 100 percent review of all incoming documents for* *completeness. Written polices and procedures have been promulgated and the appropriate staff have undergone training in their use.*

FEDERAL COMPLIANCE ISSUE 3:

## Obtain Financial Aid Transcripts

(Prior Audit Issue)

**The University is not obtaining financial aid transcripts for all transfer students who receive federal financial assistance.** The students were therefore ineligible to receive the funds, resulting in questioned costs of $52,315.78.

Twelve of the 81 (14.8 percent) *Federal Family Education Loans* program (CFDA 84.032) and *Federal Pell Grant Program* (CFDA 84.063) student files tested did not include a transcript obtained in accordance with federal regulations.

*Title 34 of the Code of Federal Regulations (CFR), § 668.19*, requires that a financial aid transcript be obtained for any student who previously attended another eligible institution. The transcript must be signed by an official authorized by the institution providing the transcript.

Recommendation:

We recommend the University obtain financial aid transcripts for all transfer students before disbursing federal financial assistance. If valid transcripts cannot be obtained for those students noted above, the questioned costs of $52,315.78 should be returned to the federal financial assistance programs.

*Management's Response*:

*The University acknowledges that Financial Aid Transcripts (FAT) were not obtained for the twelve students prior to the awarding of financial aid or at the time of the audit. However upon audit identification of this oversight, the University has requested and obtained the required FATs for all twelve students. Consequently, the University requests a waiver of the questioned costs of $52,315.78 from the Department of Education.*

*Policies and procedures have been established and are being communicated to students and staff regarding the necessity of obtaining FATs whenever a student has previously attended another institution. In addition, the SCT-Banner Financial Aid System requires positive indications of the presence of all required forms prior to the awarding of financial aid.*

FEDERAL COMPLIANCE ISSUE 4:

## Ensure That Financial Aid Given to Students Does Not Exceed Their Need

(Prior Audit Issue)

**The University is not ensuring that financial aid given to *Federal Pell Grant Program* (CFDA 84.063) and *Federal Family Education Loans* program (CFDA 84.032) recipients does not exceed their need.** Six of the 79 (7.6 percent) files tested indicated students received financial aid which exceeded their need. This resulted in questioned costs of $7,058.

In two of the six files, the students were awarded funds using an incorrect budget. In the remaining four files, the budgets were overstated due to an error in calculating the loan origination fees. Because the students were awarded the full amount of their financial need, this resulted in an overaward.

*Title 34 of the Code of Federal Regulations (CFR), § 682.603,* states that a school may not certify a Stafford (subsidized or unsubsidized) or PLUS loan application for a loan amount that exceeds the student's financial need. In addition, the Student Financial Aid Handbook states that a school may either use the exact fees charged to the student or determine an average figure, based on the average loan borrowed at the school, to calculate the origination fees.

<u>Recommendation</u>:

We recommend the University ensure that financial aid given to students does not exceed their need. This can be accomplished by ensuring that loans are not certified for amounts that would exceed the student's need and by changing the method used to calculate loan origination fees. In addition, total questioned costs of $7,058 should be returned to the lender.

*<u>Management's Response</u>*:

*The University agrees that the formula for calculating the loan processing fee was inaccurate and has corrected the formula by adopting an approved method. Questioned costs of $245 resulting from the incorrect formula will be repaid. The remaining questioned costs of $6,813 were the result of failure to properly document residential status of one student and the personalized budget of another student. The University has subsequently discovered documentation to negate these questioned costs, and thereby will request a waiver of these questioned costs from the Department of Education. Procedures have also been established in the new SCT-Banner System to ensure that future awards of financial aid will be based upon proper classification and budgets supported by documentation.*

FEDERAL COMPLIANCE ISSUE 5:

## Maintain Complete and Accurate Student Files

(Prior Audit Issue)

**The University is not adequately maintaining complete and accurate student files to support the disbursement of federal financial assistance.** Discrepancies exist in the amounts awarded and disbursed, the University was unable to locate certain documentation, and the automated information system contains inaccurate and incomplete information. Failure to maintain complete and accurate records can result in erroneous disbursements of aid. The University is financially responsible for returning improperly disbursed federal funds.

Our review of 241 student files and the automated financial aid system indicated the following:

**Discrepancies in Amounts Awarded and Disbursed -** Award information in the physical files does not correspond to the information on the automated student information system. In several cases, revisions to original award amounts that appeared on the automated system were not documented in the students' files. In addition, several files contained check release forms signed by the student for loan checks that appeared to be disbursed, but were actually returned to the lender. In these cases, neither the files nor the automated system contained any documentation that the check was returned to the lender, and the banks had to be contacted to determine if the check was actually returned or cashed.

These discrepancies make it difficult to determine the actual amount disbursed to a student, and could result in funds being awarded to ineligible students or incorrect amounts being awarded to eligible students.

**Inability to Locate Documentation -** Although progress has been made since fiscal year 1993, the Student Financial Aid office staff could not locate or had difficulty locating some of the files and information we requested. The file out-cards did not always accurately reflect the location of the student files. Three percent (1 of 40) of the *Federal Family Education Loans* program - *FFELP* (CFDA 84.032) files selected for testing could not be found, resulting in questioned costs of $8,925. In addition, 15 percent (6 of 40) of the *FFELP* loan applications tested were not in the student's file and several check release forms could not be found. We also noted several instances in which multiple files existed for the same student and several instances in which student files contained records which belonged in other students' files.

Inadequate filing practices make it difficult to determine compliance with the federal program requirements, and can result in the disbursement of funds to ineligible students or in disbursements to eligible students which are not properly supported.

**Incomplete and Inaccurate Information on the Automated Information System-** Award and disbursement information is not consistently or accurately entered on the automated information system. Check release dates for all loan checks were not entered on the automated system. Although the automated system shows $31 million in loans awarded during the audit period, it only shows $6 million in loans being disbursed. In addition, a report was generated that shows 1,158 instances where the automated system shows loan checks received by the University, but there is no corresponding award file for the students. Upon further investigation, it appears that the majority of these instances are the result of errors in entering the loan type on the system.

Due to the incomplete and inaccurate information on the automated information system, it is difficult for staff to determine the type of loan a student was awarded and if a student's loan checks have been disbursed. Consequently, incorrect loan disbursements could be made to students.

*Title 34 of the Code of Federal Regulations (CFR), § 668.23 (h)*, requires institutions administering federal financial aid programs to establish and maintain adequate student records. Files should support student eligibility and awards, and be systematically organized.

Recommendation:

We recommend the University adequately maintain complete and accurate student files to support the disbursement of federal financial assistance. The University should implement procedures to ensure that the amounts awarded and disbursed (including any revisions) are correctly and consistently documented in the student files and on the automated system. In addition, a thorough review should be undertaken to locate the missing file and documents, and procedures should be implemented to ensure that items are not misfiled or misplaced in the future. The University should also ensure that controls exist in their new automated information system to prevent incomplete and inaccurate information from being entered. Furthermore, the questioned costs of $8,925 should be returned to the federal financial assistance programs.

*Management's Response*:

*All three subheadings in this finding are being addressed by the new SCT-Banner Financial Aid System. Operating policies and procedures put into place with this new computerized system include strengthening document tracking and data input controls to ensure data integrity. Included are check points for reconciliation of paper files and computer files and for the reconciliation of amounts awarded and amounts disbursed. These check points include sign-off steps by responsible employees. Training is being conducted to instill and re-enforce these new procedures, and disciplinary actions have been identified to ensure staff accountability. Finally, filing room procedures have been strengthened.*

*The questioned costs of $8,925 will be returned to the lender unless the student's file is subsequently found.*

FEDERAL COMPLIANCE ISSUE 6:

## Ensure That Annual Loan Limits Are Not Exceeded

(Prior Audit Issue)

**The University is not ensuring that *Federal Family Education Loans* program (CFDA 84.063) recipients do not exceed annual loan limits set by the Department of Education.** Three of the 41 (7.3 percent) student files tested indicated students received loans in excess of their annual loan limits, resulting in unguaranteed student loans in the amount of $2,898.

*Title 34 of the Code of Federal Regulations (CFR), § 682.506(a)(2),* states that the Department of Education does not guarantee loans in excess of the permissible annual and aggregate loan limits.

Recommendation:

We recommend the University ensure that annual loan limits are not exceeded. The University should implement procedures for tracking loan amounts borrowed by students. Additionally, the lenders should be notified about the unguaranteed loans for these borrowers.

*Management's Response*:

*The University has implemented a new computer system for the 95-96 academic year which will track all loans. This system will act as a safeguard by tracking dates, amounts awarded, number of loans and loan checks disbursed for all FFELP programs. The University will notify affected lenders of any unguaranteed amount identified in the audit.*

FEDERAL COMPLIANCE ISSUE 7:

## Submit a Default Management Plan to Secretary for Approval

**The University has not submitted its current default management plan to the Secretary for approval for the *Federal Family Education Loans* program - *FFELP* (CFDA 84.032).** The University is currently using a default management plan that deviates from Appendix D of the General Provisions regulations, and has not been submitted for approval by the Secretary of the Department of Education. For the past four years, the University's default rate has been greater than 20 percent. High default rates can result in termination of the federal program.

*Title 34 of the Code of Federal Regulations (CFR), § 668.17,* requires that if an institution's cohort default rate for *FFELP* loans is greater than 20 percent, a default management plan must be approved and implemented. The institution may adopt Appendix D of the General Provisions regulations, or develop its own plan. If the institution elects to develop its own plan, it must justify the rationale for any deviations from Appendix D explaining why the measures are not appropriate for their situation. Once the institution receives notice that the Secretary has approved the plan, it must be implemented.

Recommendation:

We recommend that the University submit a default management plan to the Secretary for approval.

*Management's Response*:

*The University will review Appendix D and determine whether to accept Appendix D or submit its own Default Management Plan for the Federal Family Education Loans program (CFDA 84.032). The plan will be completed, submitted and implemented as soon as possible, but no later than March 1, 1996.*

FEDERAL COMPLIANCE ISSUE 8:

## Comply with Regulations for Awarding Athletically-Related Financial Aid

**The University is not complying with regulations for awarding athletically-related financial aid for the *Federal Pell Grant Program* (CFDA 84.063) and the *Federal Family Education Loans* program - *FFELP* (84.032).** The University has never prepared an annual report detailing athletic revenues and expenses, or obtained an audit of this annual report as federally required. Because this requirement is part of the University's Program Participation Agreement, failure to comply could result in the loss of eligibility to receive federal financial assistance.

*Title 34 of the Code of Federal Regulations (CFR), § 668.14,* requires that an annual report be compiled, and an independent audit be performed every three years no later than six months after the end of the University's fiscal year. The annual report must include revenues and expenses derived from the institution's intercollegiate athletic activities broken out by sport, and the total revenues and operating expenses of the institution.

Recommendation:

We recommend that the University comply with regulations for awarding athletically-related financial aid. The University should prepare an annual report detailing the revenues and expenses of athletic aid, and retain an independent auditor at least every three years.

*Management's Response*:

*We concur with the recommendation. The University will comply with regulations for awarding athletically-related financial aid for the Federal Pell Grant Program (CFDA 84.063) and the Federal Family Education Loans program - FFELP (CFDA 84.032). At the end of fiscal year 1995-96, the Financial Division will prepare an annual report detailing the revenues and expenses of athletic aid. An independent audit will be initiated and performed each year to comply with the 3 year time period regulation.*

FEDERAL COMPLIANCE ISSUE 9:

## Report Enrollment Changes

(Prior Audit Issue)

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

For 100 percent (25 of 25) of the student files tested, the enrollment changes were not reported within the required time frame. In addition, the University did not return several of the Student Status Confirmation Reports (SSCRs) within the required 30 days, and did not maintain copies of some of the SSCRs after completion.

*Title 34 of the Code of Federal Regulations (CFR), § 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. In addition, the regulations also state that an institution shall complete and return SSCRs within 30 days of receipt from the guarantee agency or lender, and shall keep copies of the completed reports for five years.

Recommendation:

We recommend the University report enrollment changes to lenders within the required time frames. In addition, the University should ensure that all SSCRs are returned within 30 days, and that copies of these reports are maintained.

*Management's Response*:

*Effective immediately, the Registrar's Office will complete all Student Status Confirmation Reports (SSCRs) within the required time frame. In addition, the Registrar's Office will also send a list of graduates to each lender at the appropriate times. This new SCT-Banner financial aid system will also allow the Financial Aid Office to monitor enrollment changes in a more timely manner. Copies of the completed SSCRs and graduation lists will be maintained by the Registrar.*

FEDERAL COMPLIANCE ISSUE 10:

## Provide Loan Counseling to Students

(Prior Audit Issue)

**The University is not providing loan counseling to all recipients of the *Federal Family Education Loans* program (CFDA 84.032).** Sixteen of 41 (39 percent) files tested for first-time borrowers did not contain documentation of loan entrance counseling prior to the release of loan proceeds. Twenty-one of 25 (84 percent) files tested for borrowers who ceased to be enrolled at least half-time did not contain documentation of exit counseling. Inadequate counseling procedures may result in excessive loan default rates.

*Title 34 of the Code of Federal Regulations (CFR), § 682.604(f),* requires institutions to conduct entrance counseling prior to the release of the first loan disbursement for first-time borrowers. *Title 34 of the CFR, § 682.604(g),* requires that institutions conduct in-person exit counseling with each borrower shortly before the borrower ceases to be enrolled at least half-time. The section further states that the school shall maintain in the student borrower's file documentation of such loan counseling.

Recommendation:

We recommend the University provide loan counseling to recipients of the *Federal Family Education Loans* program (CFDA 84.032). Documentation of loan counseling should be maintained in the student files.

*Management's Response*:

*The mandatory entrance counseling program for all borrowers who do not have documentation in their file confirming prior entrance counseling has been restructured as follows:*

- *All new applicants will be required to go through entrance counseling prior to the release of loan checks.*

- *All returning students who did not have entrance counseling documentation will be required to complete entrance counseling.*

*In addition, the University will require the Registrar's Office to direct students who wish to withdraw or drop below full time status to receive exit counseling from the Financial Aid Office prior to the change in status. This policy will become effective on February 1, 1996.*

FEDERAL COMPLIANCE ISSUE 11:

## Ensure Payment Authorization for University Obligations Is Optional

**The University is not ensuring that payment authorization for university obligations for the *Federal Pell Grant Program* (CFDA 84.063) and *Federal Family Education Loans* program - *FFELP* (CFDA 84.032) recipients is optional.** The Bursar's Office is currently deducting any outstanding university obligations from the student's award proceeds before releasing *Federal Pell Grant* and *FFELP* checks. As a result, federal funds are being used to pay for items other than educational expenses.

*Title 34 of the Code of Federal Regulations (CFR), §§ 690.78 (a)* and *682.604 (d)*, states that institutions may use *Federal Pell Grant* and *FFELP* awards to pay charges other than tuition and fees and room and board (if provided by the institution) only if the student authorizes such payment in writing. However, the institution may not require the student to authorize such payments.

Recommendation:

We recommend that the University ensure that payment authorization for university obligations is optional for students with financial assistance. The University should make students aware that payment of institutional debt is not a condition for *Federal Pell Grant* or *FFELP* disbursement, and should modify the Bursar's procedures to not deduct outstanding institutional debt automatically from federal financial assistance.

*Management's Response*:

*The University will develop an authorization form making students aware that institutional debt other than tuition, fees and housing can only be deducted from Pell and FFELP disbursements with the student's written authorization. This form and the posting of this policy will be coordinated by the Fiscal/Comptroller offices and will be implemented by January 8, 1996.*

## State Compliance

STATE COMPLIANCE ISSUE 1:

### Use Standardized Budget for Law School

**The Thurgood Marshall School of Law Student Financial Aid Office is not using the standardized student budget approved by the Texas Higher Education Coordinating Board (THECB).** The University's main Student Financial Aid office (SFA) has implemented a standardized student budget which has been approved by the THECB for the state aid programs. However, the Law School's SFA office uses a student budget with room, board, transportation, and personal expenses which are $4,451 higher than the standardized budget approved by THECB, and with tuition and fees expenses which are $400.50 higher than the University's schedule of tuition and fee charges for full-time law students. Using an incorrect student budget, when awarding aid, could cause aid to be awarded in excess of actual need.

For state aid programs, the Texas Higher Education Coordinating Board's (THECB) program rules and policies require institutions to annually submit student budgets for review and approval by the THECB. Once a budget is approved, tuition, fees, and books may vary for the different graduate school disciplines. However, room, board, transportation, and personal expenses must remain the same for all disciplines.

Recommendation:

We recommend that the Thurgood Marshall School of Law SFA Office use the standardized student budget approved by the THECB. The SFA office should ensure that the room, board, transportation, and personal expenses in the law student budget are the same as other disciplines at the University. In addition, the tuition and fee expenses should be the same as the University's schedule of tuition and fees for law students.

*Management's Response*:

*Thurgood Marshall School of Law Student Financial Aid Office will develop standardized budgets for law students based upon the central Student Financial Aid*

*Office standard budget for non-campus-resident students. It will be submitted to the Texas Higher Education Coordinating Board for approval.*

## Audit Scope

### Bonds

The primary focus of our audit was on the University's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report.* At August 31, 1995, Texas Southern University reported two outstanding bond issues, totaling $20 million.

We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines.

### Federal Compliance

The primary focus of our audit was on the University's two largest student financial assistance programs: the *Federal Family Education Loans* program 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 fiscal year 1993 management letter comments related to student financial assistance. For fiscal year 1995, the total dollar value of the programs at the University are as follows:

| | |
|---|---|
| *Federal Family Education Loans* program | $31,880,747 |
| *Federal Pell Grant Program* | $ 9,640,272 |

## Overall Conclusion

Texas State Technical College - Waco (College) is generally complying with federal regulations regarding the *Federal Family Education Loans* program ($6.3 million) and the *Federal Pell Grant Program* ($2.8 million) student financial assistance programs. However, areas needing improvement include separating the duties of processing and receiving loan checks, providing timely exit counseling information, and reporting enrollment changes in a timely manner.

## Internal Control Issue

INTERNAL CONTROL ISSUE 1:

### Strengthen Controls over Receipt of Loan Proceeds

**The Student Financial Assistance (SFA) Office at Texas State Technical College - Waco should strengthen controls over the receipt of loan proceeds from the lenders of the *Federal Family Education Loans* program (CFDA 84.032).** Currently, the SFA Office is receiving loan proceeds from the lenders. Since the SFA Office both processes the loan applications and receives the loan proceeds from the lenders, the risk increases that SFA personnel could process unauthorized loans and retain the loan proceeds when they are received without being detected.

*Title 34 of the Code of Federal Regulations (CFR), § 668.16(c)*, 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 College strengthen controls over the receipt of loan proceeds from the lenders. This can be accomplished by having all the loan proceeds delivered directly from the lenders to the Business Office, instead of the Student Financial Aid Office.

*Management's Response*:

*TSTC Waco concurs with the auditors' finding. Effective immediately, lenders are being notified to send loan proceeds to the Business Office at TSTC Waco instead of the Student Financial Aid Office. This procedure will eliminate the risk of personnel in the SFA office processing unauthorized loans and retaining the loan proceeds.*

*The Business Office will retain all checks received and forward a copy of each check to the SFA office for release authorization. The releases will be matched up with the checks in the Business Office by Business Office personnel prior to the distribution date.*

## Federal Compliance Issues

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

FEDERAL COMPLIANCE ISSUE 1:

### Provide Timely Exit Counseling Information

**The College is not providing timely exit counseling (loan repayment) information to all recipients of the *Federal Family Education Loans* program (CFDA 84.032).** Timely exit counseling information was not provided for 96 percent (24 of 25) of the student files tested. Nine files did not contain any exit counseling documentation, while 15 files showed that exit counseling was not provided in a timely manner. Inadequate exit counseling procedures could result in an increased loan default rate.

*Title 34 of the Code of Federal Regulations (CFR), § 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 College provide timely exit counseling information to all students who cease to be enrolled at least half-time and that documentation be maintained in the students' files.

*Management's Response*:

*TSTC Waco concurs with the auditors' finding and has taken steps to assure that timely exit counseling is provided to all recipients of the Federal Family Education Loans program. Previously, students who withdrew or dropped below half-time within a quarter have been given exit counseling information at the time the student brought their withdrawal form to the Financial Aid Office. Documentation was not placed in the file of those students who did not complete the form prior to leaving the office. Steps have been taken to correct this.*

*Additionally, the institution has mailed exit counseling information to those students who failed to attend the group counseling session within 30 days of receipt of the completed Student Status Confirmation Report. Hereafter, procedures are being modified so that those who graduate will receive exit counseling information within 30 days of their last class day. Those students who fail to return for the next quarter will receive exit counseling information within 30 days after the ninth class day (which is the last date a student may enroll for the term).*

*All exit counseling information will now be sent through the Financial Aid computer module so that documentation of the date of counseling may be easily confirmed.*

FEDERAL COMPLIANCE ISSUE 2:

## Report Enrollment Changes in a Timely Manner

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

For ten percent (3 of 30) of the student files tested, the enrollment changes were not reported within the required time frame. In addition, procedures are not sufficient to report the correct effective date for students who drop below full time.

*Title 34 of the Code of Federal Regulations (CFR), § 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 that the College report enrollment changes to lenders within the required time frames. Procedures should also be developed to report the correct effective date for students who drop below full-time.

*Management's Response*:

*TSTC Waco concurs with the auditors' finding and has already completed the necessary computer programming to insure that enrollment changes are accurately reported in a timely manner.*

## Audit Scope

The primary focus of our audit was on the College's two largest student financial assistance programs: the *Federal Family Education Loans* program 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. For fiscal year 1995, the total dollar values of the programs at the College are as follows:

| | |
|---|---|
| *Federal Family Education Loans* program | $6,342,616 |
| *Federal Pell Grant Program* | $2,775,861 |

## Overall Conclusion

The Texas Department of Transportation (Department) has a system in place to ensure compliance with regulations for its largest federal program, *Highway Planning and Construction* ($1.1 billion). However, the Department is not adequately protecting Contract Information System data from test program processing. In fiscal year 1995, the Contract Information System processed 2,200 contracts and $1.6 billion in contractor payments.

## Related Reports

The State Auditor's Office has performed work related specifically to contract administration. Additional information is provided by this work, which goes beyond the federal compliance requirements covered by the statewide audit. The contract administration reports include recommendations to improve the State's ability to protect public funds from fraud, waste, or inefficient use by contractors. Further review of contract administration processes is planned by the State Auditor's Office and will include work at the Department.

## Internal Control Issues

INTERNAL CONTROL ISSUE 1:

### Protect Contract Information System Data

**The Department does not protect Contract Information System data from test program processing.** Test programs are programs in various stages of development which are not approved for processing operational data. This increases the risk that contract information could be improperly deleted or changed, resulting in incorrect contractor payments.

The Contract Information System contains information for 2,200 contracts and processed $1.6 billion in contractor payments during fiscal year 1995. Currently, procedures are not in place to prevent inappropriate addition or modification of contracts.

Recommendation:

We recommend the Department protect contract information by implementing controls to prevent test program processing against operational data.

Management's Response:

*We agree that the capability exists for test programs to improperly delete or change production Contract Information System data. However, the Texas Department of Transportation is presently evaluating a proprietary system which could provide the capability to prevent unauthorized access by test programs. Implementation of the system is dependent on satisfactory testing and evaluation.*

*The Department's efforts to implement a satisfactory solution will continue until one is found. Until then, the Department will continue to systematically produce reports and follow up on any test programs that may attempt to update production Contract Information System files.*

INTERNAL CONTROL ISSUE 2:

## Prevent Unsupported Contractor Payments

**The Laredo and Houston Districts do not have adequate controls in place to prevent unsupported payments**. Source documents were not retained to validate payments to the contractor. In addition, documentation was not prepared prior to paying a contractor.

The lack of adequate controls resulted in the following unsupported payments:

- questioned costs of $12,820 in the Laredo District due to destruction of payment records
- arbitrary payments of $91,850 and untimely payments of $128,313 in the Houston District

Lack of adequate payment documentation could result in errors and questioned costs that must be returned to the Federal Government.

*Title 49 of the Code of Federal Regulations (CFR), subtitle A, subpart C*, states that program recipients are to maintain adequate accounting records. Texas statute (*13 TAC 6.104.1005* and *5.3.008*) states that inventory and other cost files must be maintained for a period of not less than three years.

Recommendation:

The Department should follow existing procedures to:

- Ensure all payments associated with construction contracts are supported by adequate and timely documentation.

- Enforce records retention policy.

*Management's Response*:

*We concur with the finding. These individual items have been addressed by each district. The Department is in the process of implementing new procedures and tools to ensure a quality product for our customers. Specifically, these new procedures as well as present procedures for such items as contractor payments, were outlined in the Construction Project Records Management Workshop that was presented to all districts in the latter part of 1995. In addition to this, a special provision has been approved for statewide use to transfer the responsibility of tracking and reporting Material-on-Hand quantities from the Department to the contractor. The department is also engaged in a joint development task force with the American Association of State Highway and Transportation Officials (AASHTO) to bring automation into the construction project field office to assist in contract record keeping. Automation will enhance uniformity of data collected throughout the state, improve the quality and reliability of construction records and provide capability of audits of record keeping and documents to be completed via computer.*

*With continued as needed training and the development of innovative tools or procedures, we feel that accounting controls can be strengthened to guarantee all payments are accurate and properly recorded.*

## Federal Compliance Issue

The Department's most significant federal program, *Highway Planning and Construction* (CFDA 20.205), is funded by the U.S. Department of Transportation through the Federal Highway Administration. During fiscal year 1995, this program expended $1.1 billion for federally funded projects.

The recommendation addressed in the first section of this report could impact controls over federal funds, especially for the Department's most significant federal program.

FEDERAL COMPLIANCE ISSUE 1:

### Submit Final Vouchers on a Timely Basis

**The Department is not submitting final vouchers on a timely basis.** Eighteen percent (8 of 45) of the final vouchers tested were submitted more than 12 months after the final acceptance date of the project. The Department completed 357 final vouchers in fiscal year 1995.

Federal requirements state that final vouchers are to be promptly submitted. Region VI of the Federal Highway Administration has interpreted "prompt submission" to be within one year of the Federal Highway Administration'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 circumstances that sometimes cause final vouchers to be submitted later than one year after project completion:*

1. *The final clearance from FHWA has not been received.*

2. *There is insufficient federal apportionment to apply to the project, i.e., we are waiting to free up some apportionment on one or more other projects so we can collect all of the federal share of the project funding on the subject project.*

3. *There is insufficient federal obligation authority to apply to the project, i.e., we are waiting for some obligation authority to become available so we can collect all of the federal share of the project funding on the subject project.*

*The circumstances described in Nos. 2 and 3 above should be greatly reduced, if not eliminated in the coming years because of a recent policy change that will increase the amount of funding set aside for contingencies. However, this change will only affect new projects. Since it was not retroactively applied to all existing projects, the cited problem will continue as existing projects are closed. The normal life of projects would suggest that it may take four to five years before this will no longer be an issue.*

*Our policy is to submit final vouchers as soon as possible, and within the one year from the date of acceptance of the project whenever possible. We continue to strive to improve our record.*

## Audit Scope

The primary focus of our audit was the Department's financial and administrative controls over the *Highway Planning and Construction* program ($1.1 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.

## Overall Conclusion

The accounts in the Texas State Treasury's *1995 Annual Financial Report* that were tested as part of the statewide financial audit are materially accurate and properly reported. These accounts included Total Investments for Departmental Operations, $4.7 billion and Total Investments for Custodial Operations, $6.7 billion. However, the State Treasury does not perform comprehensive reconciliations for investments held in custodial accounts.

## Internal Control Issue

INTERNAL CONTROL ISSUE 1:

### Perform Comprehensive Reconciliations of Investments

**Comprehensive reconciliations of investments held in two of the four accounts at the Federal Reserve Bank are not performed. In addition, reconciliations are not performed for two other custodial banks that hold investments for the State Treasury.** Various divisions within the State Treasury perform segmented reconciliations of the Federal Reserve Bank accounts. However, no comprehensive reconciliation is performed to ensure that all investment records are complete and properly recorded.

Without performing a comprehensive reconciliation of investments in the custodial accounts, errors and exceptions can occur and go undetected. For example, the audit revealed the following errors in Treasury records:

- Investments were entered without CUSIP numbers (unique identifying number).
- CUSIP numbers were entered incorrectly.
- Incorrect custodian bank was recorded.

Other controls exist which mitigate the risk that investments could be withdrawn from custodian banks without authorization. A comprehensive investment reconciliation would provide additional controls to ensure that the State Treasury's records are accurate and investments are properly accounted for. The errors noted above could have been detected and corrected in a timely manner had comprehensive reconciliations been performed each month.

<u>Recommendation</u>:

We recommend that comprehensive reconciliations of investments held in custodial banks be performed monthly by someone independent of the investment function and reviewed to ensure the accuracy of accounting records.

*Management's Response*:

*Treasury's management will further review current reconciliation procedures being performed by the various divisions of the Treasury. Internal Audit will coordinate the implementation of any new procedures which would provide appropriate follow through to constitute a monthly comprehensive reconciliation of investments held in custodial accounts.*

## Audit Scope

The primary focus of our audit was the State Treasury'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 of state deposits. We tested certain financial accounts, including investments, funds held for others, and obligations under reverse repurchase agreements.

## Overall Conclusion

The University of North Texas (University) has established a system that ensured compliance with significant bond covenants during fiscal year 1995. The bond schedules and bond-related "Notes to the Financial Statements" in the University's *1995 Annual Financial Report* are materially correct and in conformity with the Comptroller's reporting requirements for annual financial reports. At August 31, 1995, the University of North Texas reported three outstanding bond issues, totaling $26 million.

The University is generally complying with federal regulations regarding the *Federal Family Education Loans* program ($37.9 million) and the *Federal Pell Grant Program* ($5 million) student financial assistance programs. However, areas needing improvement include strengthening controls over loan proceeds; ensuring aid does not exceed a student's need; and delaying disbursements to first-time, first-year students. In addition, the University should implement procedures to ensure that payment authorization for University obligations is optional, to ensure that loan proceeds are disbursed at prescribed times, to provide timely exit counseling information, and to report enrollment changes in a timely manner.

## Internal Control Issue

INTERNAL CONTROL ISSUE 1:

### Strengthen Controls over Receipt of Loan Proceeds

**The University's Student Financial Assistance (SFA) Office should strengthen controls over the receipt of loan proceeds from the lenders of the *Federal Family Education Loans* program (CFDA 84.032).** The SFA Office is currently receiving loan proceeds from the lenders, as well as processing the loan applications. This increases the risk that SFA personnel could process unauthorized loans and retain the loan proceeds when they are received without being detected.

*Title 34 of the Code of Federal Regulations (CFR), § 668.16(c)*, 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 University strengthen internal controls over the receipt of loan proceeds from lenders. This can be accomplished by having all loan proceeds delivered directly to the Bursar's Office instead of the Student Financial Assistance Office.

*Management's Response*:

*We believe our internal controls within the Financial Aid Office provide adequate separation of duties. The Counseling Section makes awards and the Loan Processing Area receives and data-enters all incoming checks. These two sections report through different supervisors to the Director of Financial Aid. Checks are then delivered to the Bursar's Office for release to the student.*

*However, we will comply with the recommendation that loan checks be sent directly from the lender to the Bursar's Office for disbursement. By February 15, 1996, the Financial Aid Office will notify lenders in writing of the proper address for delivery of checks. Lenders will be notified of this change to be effective immediately upon lender notification.*

## Federal Compliance Issues

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

FEDERAL COMPLIANCE ISSUE 1:

### Ensure that Financial Aid Given to Students Does Not Exceed Their Need

**Procedures do not ensure that financial aid given does not exceed need in instances where *Federal Pell Grant Program* (CFDA 84.063) and *Federal Family Education Loans* program (CFDA 84.032) recipients also receive non-federal aid.** Four of 37 (10.8 percent) student files tested indicated students received financial aid which exceeded their financial need. This resulted in questioned costs of $3,812.20. The University is liable for all aid given in excess of a student's calculated need.

*Title 34 of the Code of Federal Regulations (CFR), § 682.604,* states that if a school learns before a loan is disbursed that the borrower will receive financial aid that exceeds the amount of assistance for which the student is eligible, the school shall reduce or eliminate the overaward. The overaward can be eliminated by either using the student's PLUS or nonsubsidized loan to cover the expected family contribution, returning the entire undelivered disbursement to the lender, or returning to the lender the portion of the disbursement for which the student is ineligible.

Recommendation:

We recommend that the University enhance procedures to ensure that financial aid given does not exceed need in instances where *Federal Pell Grant Program* (CFDA 84.063) and *Federal Family Education Loans* program (CFDA 84.032) recipients also receive non-federal aid. In addition, total questioned costs of $3,812.20 should be returned to the lender.

*Management's Response*:

*Original loan certifications met compliance requirements.*

*Management procedures have been implemented which will strengthen internal control over existing computerized programming designed to coordinate "other resources" received by students after original loans are certified. Reports of overawards are now worked daily. Management will review effectiveness on an ongoing basis. Checks for overaward amounts will be returned to lenders.*

FEDERAL COMPLIANCE ISSUE 2:

## Delay Disbursements to First-Time, First-Year Borrowers

**The University does not delay the initial disbursement of *Federal Family Education Loans - FFELP* (CFDA 84.032) to all first-time, first-year borrowers.** Disbursements were not delayed for the required 30 days in 3 of the 25 (12 percent) student files tested. Failure to properly delay disbursements to first-time borrowers could result in the distribution of loan funds to ineligible borrowers.

*Title 34 of the Code of Federal Regulations (CFR), § 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 (subsidized or unsubsidized) loan, not be released until 30 days after the first class day.

Recommendation:

We recommend that the University ensure delayed disbursements to all first-time, first-year borrowers for the required 30 days.

*Management's Response*:

*The Financial Aid Office will ensure delayed disbursements to all first-time, first-year borrowers until 30 days after the first class day has elapsed, by implementing additional edit checks in the release of funds programming system. This will preclude* *funds from being released early. This edit was placed in production prior to the September 27, 1995, date of receipt for loan proceeds for this class of students.*

FEDERAL COMPLIANCE ISSUE 3:

## Ensure Payment Authorization for University Obligations Is Optional

**The University's procedures do not ensure that payment authorization for University obligations for *Federal Pell Grant Program* (CFDA 84.063) and *Federal Family Education Loans* program - *FFELP* (CFDA 84.032) recipients is optional.** The statement on the Financial Aid Eligibility Notice, which authorizes outstanding university obligations to be deducted from the students' award proceeds, is listed as a condition for receiving financial aid. Students must sign the statement in order to receive their award proceeds. As a result, federal funds are being used to pay for items other than educational expenses.

*Title 34 of the Code of Federal Regulations (CFR), §§ 690.78 (a)* and *682.604 (d)*, states that institutions may use *Federal Pell Grant* 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.

Recommendation:

We recommend that the University ensure that payment authorization for University obligations is optional for students with financial assistance. The University should make students aware that payment of institutional debt is not a condition for *Federal Pell Grant* or *FFELP* disbursement. This can be done by rewording or omitting the related statement contained on the Financial Aid Eligibility Notice.

*Management's Response*:

*The statement students sign authorizing current year charges other than "allowable charges" to be deducted from financial assistance has been reworded to allow a "yes" and "no" response for the student. The change has been implemented.*

FEDERAL COMPLIANCE ISSUE 4:

## Ensure That Loan Proceeds Are Disbursed at Prescribed Times

**The University is not ensuring that loan proceeds are disbursed to students at the prescribed times for the *Federal Family Education Loans* program (CFDA**

**84.032).** In 4 of 30 (13 percent) student files tested, students who received a loan for only one semester were given both disbursements at the beginning of that semester. Currently, the Student Financial Assistance Office does not have procedures in place to ensure that these students do not receive their second disbursement until midway through the semester.

*Title 34 of the Code of Federal Regulations (CFR), § 682.207(c)*, states that at least one half of the period of enrollment for which the loan is made must elapse before the second disbursement is made. Although the lender is responsible for making the disbursements, it is the school's responsibility to provide disbursement dates.

Recommendation:

We recommend that the University ensure loan proceeds are disbursed at the prescribed times. This can be accomplished by changing the disbursement dates provided to lenders and by implementing procedures which would preclude funds from being released early.

*Management's Response*:

*The procedure in question was corrected prior to the audit during the Spring Semester, 1995. The Financial Aid Office is now providing appropriate disbursement dates to lenders for single semester loans. By October 17, 1995, we implemented procedures and programming edits to our automated release of funds system which precludes funds from being released early, in the event lenders send money prior to the requested date.*

FEDERAL COMPLIANCE ISSUE 5:

## Provide Timely Exit Counseling Information

**The University is not providing timely exit counseling (loan repayment) information to all recipients of the *Federal Family Education Loans* program (CFDA 84.032).** Six of 25 (24 percent) student files tested indicated the student did not receive timely exit counseling. Two of six files did not contain documentation of exit counseling. Documentation in the other four files indicated exit counseling was not provided in a timely manner. Inadequate exit counseling procedures could result in an increased loan default rate.

*Title 34 of the Code of Federal Regulations (CFR), § 682.604 (g),* requires that the institution conduct in person exit counseling with each borrower shortly before the borrower ceases to be enrolled at least half-time. If a student withdraws from the school or does not attend a counseling session, exit counseling 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.

*Management's Response*:

*The Financial Aid Office will continue to provide exit counseling sessions for students who cease to be enrolled at least half-time or depart from the University. Additionally, improvements will be made to the automated identification process in the Fall, 1995, to ensure a thorough selection of all such students.*

FEDERAL COMPLIANCE ISSUE 6:

## Report Enrollment Changes in a Timely Manner

**The University is not reporting all enrollment changes for the *Federal Family Education Loans* program (CFDA 84.032) in a timely manner. Procedures are not sufficient to report spring graduates and summer enrollment changes as required.** Enrollment changes occur when a student graduates, withdraws, drops classes, or is expelled. Noncompliance with this requirement may result in delayed loan repayment to lenders.

Enrollment changes were not reported within the required time frames for 7 of 25 (28 percent) student files tested. One of the seven files indicated that the enrollment change was not reported at all. Documentation in the other six files indicated that enrollment changes were not reported within the required time frames.

*Title 34 of the Code of Federal Regulations (CFR), § 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 that the University report all enrollment changes to the guaranty agency or lender in a timely manner. Timely reporting of spring semester graduates can be achieved by submitting a list of confirmed graduates to the guarantor.

Procedures should also be developed to notify the lender or guaranty agency of other enrollment changes that occur during the summer semesters. The notification should be by letter within 30 days if the University does not expect to report the changes on the student status confirmation report within the next 60 days.

Management's Response:

*Six of the seven students were reported not more than 11 days late, indicating that systems are in place to support the required reporting of student enrollment changes. Most of the delays were due to "debugging" new programs required by implementation of federally mandated changes, which will allow eventual student status reporting through the National Student Loan Data Base. Electronic tapes were received from the Texas Guaranteed Student Loan Agency by the 13th day of the months in question. The certifications were completed no later than the 27th of those reporting months.*

*We will work with Texas Guaranteed Student Loan Corporation to see if processing can be expedited and tapes required for reporting can be delivered earlier in the month. We will work to improve institutional turn-around time on the tapes received. Since program "debugging" occurred in the 1994-95 year, some improvements can be made in this area.*

*Spring graduates are currently reported in July. In order to cure the late reporting of these students, we will run the report in June. We also will add a reporting cycle for students who enroll in summer but subsequently withdraw.*

# Audit Scope

## Bonds

The primary focus of our audit was on the University's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. At August 31, 1995, the University of North Texas reported three outstanding bond issues, totaling $26 million.

We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines.

## Federal Compliance

The primary focus of our audit was on the University's two largest student financial assistance programs: the *Federal Family Education Loans* program 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. For fiscal year 1995, the total dollar value of the programs at the University are as follows:

| | |
|---|---|
| *Federal Family Education Loans* program | $37,923,279 |
| *Federal Pell Grant Program* | $ 5,057,877 |

## Overall Conclusion

The University of Texas M.D. Anderson Cancer Center (institution) has established a system to ensure compliance with most federal regulations for the largest federal program. However, the institution needs to correct its accounts payable system to ensure that federal programs are charged only for the actual cost of purchases, net of any discounts taken. The institution received approximately $14.1 million during fiscal year 1994 and $14.8 million in fiscal year 1995 through its major federal program, *Cancer Treatment Research* (CFDA 93.395).

## Federal Compliance Issue

FEDERAL COMPLIANCE ISSUE 1:

### Allocate Purchase Discounts to Federal Grants

**The University of Texas M.D. Anderson Cancer Center (institution) does not allocate purchase discounts back to the federal grant from which the purchase was made.** The institution's automated accounts payable system is programmed to take advantage of all discounts that are beneficial to the institution, such as those that exceed the interest that could be earned by delaying payment. As a result, the Federal Government is billed for the entire amount of the invoice and the institution retains the discount for its general operations.

Our tests specifically identified $601.30 in questioned costs resulting from improper allocation of purchase discounts. However, subsequent to fieldwork, the institution's Internal Auditor identified $9,825.97 in total questioned costs for fiscal years 1994 and 1995. We did not estimate questioned costs for years prior to fiscal year 1994; however, the current accounts payable system has been in operation since 1988.

*Office of Management and Budget (OMB) Circular A-21 - Cost Principles for Educational Institutions* states that the concept of netting credit items such as purchase discounts against related expenditures should be applied by the institution in determining the amount to be charged to the federal program.

Recommendation:

Management should ensure that federal programs are charged only for the actual cost of purchases. If the automated system is unable to make a proper allocation of purchase discounts to the federal grants, some reasonable method of estimating the allocation should be developed. Also, management should review purchase discounts since the inception of the current accounts payable system to determine the amount of accumulated funds to be returned to the federal program.

*Management's Response*:

*The recommendation to allocate purchase discounts to Federal Grants and ensure that federal programs are charged only for the actual cost of purchases is appropriate and proper. The financial administration of The University of Texas M.D. Anderson Cancer Center will assure that this takes place.*

## Audit Scope

We performed tests of the controls and compliance requirements of the largest federal program for fiscal year 1994 and fiscal year 1995 at The University of Texas M.D. Anderson Cancer Center. The institution received approximately $14.1 million during fiscal year 1994 and $14.8 million in fiscal year 1995 through its major federal program, *Cancer Treatment Research* (CFDA 93.395). This program comprises approximately 30 percent of the institution's total federal funding.

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# Appendices

1995 Financial and Compliance Audit Results

SAO Report No. 96-063

May 1996

# Appendix 1:
# Audit Scopes for Agencies with No Findings

As noted in the "Our Compliments to 28 Agencies" section of this report, 28 of the 45 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 Internal Controls."

## 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. 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, the Guaranty Subaccount, and certain reporting requirements. As of August 31, 1995, the Authority reported $18.4 million in notes payable.

## 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 *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related “Notes to the Financial Statements” for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the Board reported eight bond issues outstanding, totaling $31 million.

## Commerce, Texas Department of

The primary focus of our audit was the Department’s administrative controls over the *Job Training Partnership Act* (CFDA 17.250) program, which expended over $227 million. We gained an understanding of the significant internal control structures related to this program and tested compliance with significant requirements. We performed follow-up work to determine the status of prior year issues relating to a disaster recovery plan for automated data, cash management, and weaknesses in the internal audit department.

We also tested the Department’s compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the Department reported one bond issue outstanding, totaling $99 million.

### 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 *1995 Annual Financial Report*. We gained an understanding of the bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the Texas Department of Criminal Justice reported 12 bond issues outstanding, totaling $219 million.

### 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 *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported three bond issues outstanding, totaling $1 million.

### Employment Commission, Texas

The primary focus of our audit was the Commission's financial and administrative controls over the *Unemployment Insurance* (CFDA 17.225) program. *Unemployment Insurance* expenditures totaled $1.4 billion for fiscal year 1995.

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 the *Unemployment Insurance* program. Specific procedures were used to test compliance with the *Unemployment Insurance* program.

## General Land Office and Veterans' Land Board

The primary focus of our audit was the Veterans' Land Board's loans and contracts receivables of $1.3 billion for the veterans programs. We gained an understanding of the internal control structure, including the control environment, and controls over cash receipts and cash disbursements. In addition, we tested the Veterans Loans and Contracts Receivable account.

We also tested the agency's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the agency reported 22 bond issues outstanding, totaling $1.5 billion.

## 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 *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the Council reported one bond issue outstanding, totaling $12 million.

## 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 performed substantive tests of the asset accounts, cash and investments, which relate to the account "Funds Held in Custody for Others."

## Lamar University - Orange

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported two bond issues outstanding, totaling $1.3 million.

## Lamar University - Port Arthur

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported two bond issues outstanding, totaling $1.9 million.

## 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 *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported five bond issues outstanding, totaling $3 million.

## 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 *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. All bonds outstanding in fiscal year 1995 were refunded through the Texas Public Finance Authority during the year so that at August 31, 1995, the Commission reported no bond issues outstanding.

## Public 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 *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related “Notes to the Financial Statements” for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the Authority reported 31 bond issues outstanding, totaling $2.8 billion. We also gained an understanding of the general control environment in order to test the financial accounts material to the State’s financial statements. These accounts included: due to other funds, bonds payable, and operating transfers.

## Rehabilitation Commission, Texas

The primary focus of our audit was the Commission’s compliance with the federal requirements for administering the *Rehabilitation Services-Vocational Rehabilitation Grants to States* (CFDA 84.126) and the *Social Security-Disability Insurance* program (CFDA 96.001). 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 unresolved prior audit issues.

## 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 *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related “Notes to the Financial Statements” for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported three bond issues outstanding, totaling $25 million.

## 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 *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related “Notes to the Financial Statements” for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the System Office reported one bond issue outstanding, totaling $26 million.

**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 *1995 Annual Financial Report.* We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported six bond issues outstanding, totaling $14 million.

**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 *1995 Annual Financial Report.* We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported 12 bond issues outstanding, totaling $75 million.

**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 *1995 Annual Financial Report.* We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. All bond issues outstanding in fiscal year 1995 were paid off during the year, so that at August 31, 1995, the University reported no bond issues outstanding.

## 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 *1995 Annual Financial Report.* We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported eight bond issues outstanding, totaling $55 million.

## Texas Tech University Health Sciences Center

The primary focus of our audit was the Center's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the Center reported two bond issues outstanding, totaling $25 million.

## University of Houston System

The primary focus of our audit was the System's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the System reported six bond issues outstanding, totaling $118 million.

## University of North Texas Health Science Center

The primary focus of our audit was the Center's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the Center reported two bond issues outstanding, totaling $10 million.

## University of Texas System, The

**University of Texas System Administration, The -** The primary focus of our audit was the System's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. We also examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the System reported 13 bond issues outstanding, totaling approximately $1.1 billion.

**University of Texas Health Science Center at Houston, The** - The primary focus of our audit was the University's compliance with the federal requirements for administering the *Heart & Vascular Diseases Research* program (CFDA 93.837) for fiscal years 1994 and 1995. We gained an understanding of the internal control structures related to this federal program and tested compliance with significant federal requirements.

## Water Development Board, Texas

Our audit of the Texas Water Development Board's Enterprise Fund account, "Payments to Acquire Investments", of approximately $887 million, involved gaining an understanding of controls and performing detailed test work. In addition, we reviewed the Board's compliance with significant bond covenants and the presentation of bond-related disclosures in the *1995 Annual Financial Report*. At August 31, 1995, the Board reported 35 bond issues outstanding, totaling approximately $1.2 billion. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. We also examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity 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 *1995 Annual Financial Report*. We gained an understanding of bond-related administrative and accounting controls and tested applicable revenue and expenditure accounts to determine compliance with significant bond covenants. In addition, we examined the bond schedules and bond-related "Notes to the Financial Statements" for fairness of presentation and conformity with reporting guidelines. At August 31, 1995, the University reported five bond issues outstanding, totaling $10 million.

## Appendix 2:
## Related Reports and Audits

The State Auditor's Office has performed work related specifically to contract administration. Additional information is provided by this work, which goes beyond the federal compliance requirements covered by the statewide audit. Further review of contract administration processes is planned or in progress. The following list provides the agencies where work has been completed and the associated report numbers. Also included is a listing of agencies where the State Auditor's Office is performing a review or a review is planned.

### Agencies Covered by SAO Contract Administration Projects

| | |
|---|---|
| Texas Youth Commission | SAO Report No. 96-005 |
| Texas Commission for the Blind | SAO Report No. 96-008 |
| Texas Rehabilitation Commission | SAO Report No. 96-012 |
| Interagency Council on Early Childhood Intervention | SAO Report No. 96-020 |
| Texas Department on Aging | SAO Report No. 96-030 |
| Texas Department of Health | SAO Report No. 96-047 |
| Texas Department of Human Services | SAO Report No. 96-047 |
| Texas Department of Mental Health and Mental Retardation | SAO Report No. 96-047 |
| Texas Department of Protective and Regulatory Services | SAO Report No. 96-047 |

### Agencies Scheduled for SAO Contract Administration Projects

Texas Department of Commerce[1]
Texas Department of Criminal Justice
Texas Employment Commission[1]
Texas Department of Health
Texas Department of Housing and Community Affairs
Texas Department of Human Services
Texas Juvenile Probation Commission
Texas Natural Resource Conservation Commission
Texas Department of Protective and Regulatory Services
Texas Department of Transportation

[1]Contract administration coverage may be provided during a review of the newly formed Texas Workforce Commission.

# Appendix 3
## Texas Commission on Alcohol and Drug Abuse

The Joint Senate and House Investigating Committee directed the Texas Rangers to lead a task force to investigate potential fraud at the Texas Commission on Alcohol and Drug Abuse (Commission) and their service providers (subrecipients). This task force was comprised of members of the Texas Rangers, the State Auditor's Office, the State Comptroller's Office, and the private accounting firm of Coopers & Lybrand, L.L.P.

Audit findings at the service provider (subrecipient) level were noted in the following general areas:

| Finding Type | Number of Providers |
|---|---|
| **Questionable Expenditures** - Federal funds expended in a manner that appears inconsistent with the terms and objectives of the federal program or contractual provisions. | 153 |
| **Contract Compliance** - Instances where service providers did not adhere to contract requirements and restrictions. | 142 |
| **Internal Control Weaknesses** - Inability, by service providers, to maintain an adequate system of "checks and balances" which would exercise proper fiscal management of programs and financial resources. | 124 |
| **Program Income** - Income earned from federally supported activities or as a result of awards that are not discretionary income to the provider. | 85 |
| **Double/Over Billing** - Billing two or more funding sources for the same costs while performing the same services or billing in excess of actual costs. | 70 |
| **Conflict of Interest** -Transactions entered into, with related persons or entities by agency representatives using their position, for a purpose that is, or appears to be, motivated by desire for personal gain. | 51 |
| **Potential Fraud** - An act committed by an employee or board member with the intent to defraud or obtain benefit or personal gain. | 23 |

In addition, questioned costs of state and federal funds, for the periods covered by the investigation, were in excess of $32.3 million.

Work performed included gaining an understanding of policies and procedures in place at both the Commission and the service providers (subrecipients). Tests of controls were performed at individual service provider covering revenues, expenses, indirect costs, and payroll and personnel. In addition, these investigations provided extensive coverage on compliance with requirements related to the federal program, *Block Grants for Prevention and Treatment of Substance Abuse* (CFDA 93.959)

## Appendix 4:
## What Is the Statewide Audit?

The State Auditor's Office performs an annual 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*. This 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 *Texas 1995 Comprehensive Annual Financial Report (CAFR).* Audit reports on controls and compliance are included in this report, the *1995 Financial and Compliance Audit Results*. Insignificant instances of non-compliance 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 entity'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 *Texas 1995 Comprehensive Annual Financial Report* and the *1995 Financial and Compliance Audit Results* report to those entities. Extra copies of the *Texas 1995 Comprehensive Annual Financial Report* may be obtained from the Comptroller of Public Accounts office. Extra copies of this report may be obtained from the State Auditor's Office.

The State Auditor's Office forwards copies of the *Texas 1995 Comprehensive Annual Financial Report* and *1995 Financial and Compliance Audit Results* report 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) 479-4700.

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# Index

1995 Financial and Compliance Audit Results

SAO Report No. 96-063

May 1996

# Index