

State of Texas Financial Portion of the

# Statewide Single Audit Report for the Year Ended August 31, 2003

March 2004  
Report No. 04-555



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**Statewide Single Audit Report for the  
Year Ended August 31, 2003**

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## Overall Conclusion

The State's basic financial statements for the year ended August 31, 2003, are materially correct in accordance with accounting principles generally accepted in the United States of America. These financial statements provide a comprehensive picture of how the State used its resources during the year, as well as the State's remaining assets and obligations at the end of the year.

Auditing financial statements is not limited to reviewing the accuracy of the numbers in those statements. Conducting this audit also requires us to audit the underlying systems and processes that agencies and institutions of higher education use to record their financial activities. Through that review, we identified specific weaknesses that certain agencies and institutions of higher education need to address to ensure the accuracy of their financial information.

The ability to prepare materially correct financial statements represents a significant accomplishment for the State; however, the budget issues that have arisen during the past few years remain among the State's most significant financial challenges. In addition, preparing materially correct financial statements is only one aspect of financial accountability. As our prior audit reports have demonstrated, the State continues to face significant risks in areas such as contracting, revenue management, and information technology systems. Our office continues to monitor these significant risks and incorporate them into the risk assessment we use to identify additional audit work we will conduct.

### Background Information

The State's basic financial statements include both government-wide and fund financial statements.

- Government-wide financial statements are designed to present an overall picture of the financial position of the State. These statements do not include retirement system assets, trust funds, or agency funds.
- Fund financial statements present financial information, focus on the most significant funds, and are presented in a form that is more familiar to experienced users of governmental financial statements.

New requirements of Governmental Accounting Standards Board (GASB) Statement No. 34 required us to conduct more extensive audit work to express an opinion on the State's basic financial statements this year. We audited material accounts of major funds at 20 of the State's largest agencies and institutions of higher education.

## Key Points

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

We conducted audit work at 20 of the State's largest agencies and institutions of higher education and identified control weaknesses at only 6 of them. (Appendix 2 of this report lists the agencies and institutions of higher education we audited.) This reflects well on the State's ability to accomplish the complicated task of preparing materially accurate basic financial statements. With the third largest budget among all 50 states, nearly



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*This audit was conducted in accordance with Texas Government Code, Section 321.0131.*

*For more information regarding this report, please contact Susan Riley, CPA, Audit Manager, at (512) 936-9500.*

\$74 billion in annual expenditures, and more than 200 state agencies and institutions of higher education, the State of Texas must contend with significant complexities in preparing its basic financial statements.

Although the State's basic financial statements are materially correct, the State continues to face budget issues that remain among its most significant financial challenges. In addition, our prior audit reports have demonstrated that the State continues to face significant risks in areas such as contracting, revenue management, and information technology systems. We monitor these and other risks on an ongoing basis and incorporate them into our risk assessment. Based on that risk assessment, we identify additional audits focusing on more specific topics that would not typically be covered in an audit of basic financial statements.

**Certain agencies and institutions of higher education need to address specific weaknesses to ensure the accuracy of their financial information.**

- The University of Texas Southwestern Medical Center at Dallas (Medical Center) does not properly restrict its programmers' access to its accounting system's information and applications. We previously reported this same issue in 1999. Although nothing came to our attention indicating that errors or discrepancies had occurred because of this weakness, the access that programmers currently have could allow them to enter, change, or delete accounting transactions without timely detection.
- In fiscal year 2002, we reported that the Department of Health (Department) had a material weakness in its financial reporting. Although the Department has significantly strengthened certain aspects of its financial reporting, remaining weaknesses in its financial reporting reduce the reliability of its financial information. For example, the Department has not completed reconciling information in its internal accounting system with the Uniform Statewide Accounting System (USAS).
- The Health and Human Services Commission (Commission) understated its accounts payable by \$617.9 million on its fiscal year 2003 Annual Financial Report, which led to a material understatement of its liabilities and expenditures. Understating accounts payable makes it appear as if the Commission had more funds available than it actually had at the end of fiscal year 2003. The understatement occurred because the Commission misinterpreted a rider in the General Appropriations Act.
- We identified seven buildings valued at \$92 million that Prairie View A&M University (University) misclassified by including them in its Construction in Progress account instead of in depreciable capital assets. This is significant because assets classified as Construction in Progress are not depreciated, but depreciable capital assets are. In addition, three buildings (with a total cost of \$3.3 million and a current book value after depreciation of \$1.1 million) had actually been demolished but were still erroneously included on the University's list of capital assets.
- The Water Development Board (Board) does not consistently and promptly terminate users' access rights to its automated financial systems, nor does it require users to regularly change their passwords for those systems and the Board's local area network. We did not identify any financial discrepancies that resulted from these weaknesses. However, this increases the risk that unauthorized changes could be made to financial

information, could allow for misappropriation of agency assets, and could result in the material misstatement of financial reports.

- In April 2003, we reported that the Texas Education Agency (Agency) did not reconcile school district payment amounts calculated by its Foundation School Program system with school district payments actually made through USAS. Although the Agency reconciled those payments in June 2003 and August 2003, it should further enhance its reconciliation process by reconciling other funding that is processed through the Foundation School Program system. This is important because it helps to ensure that school districts receive correct payment amounts.

## ***Summary of Managements' Responses***

The agencies and institutions of higher education to which we addressed recommendations generally agreed with our recommendations.

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

We reviewed the internal controls over significant accounting and information systems at the agencies and institutions of higher education we audited. To do that, we identified systems that compiled and contained data used to prepare financial statements for agencies and institutions of higher education and then reviewed basic data protection controls such as user access rights, location of data, and back-up processes. As discussed above, we identified certain information technology control weaknesses that The University of Texas Southwestern Medical Center at Dallas and the Water Development Board need to address to help ensure the reliability of their financial information.

We also reviewed internal controls within USAS, the State Property Accounting system (SPA), and the Uniform Statewide Payroll/Personnel System (USPS). We did not identify any significant control weaknesses during our reviews of these systems.

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

Our objective was to determine whether the State's basic financial statements accurately reflect the balances and activities for the State of Texas for the fiscal year ended August 31, 2003.

The Statewide Single Audit is an annual audit for the State of Texas. It is conducted so that the State complies with the Single Audit Amendments of 1996 and the Office of Management and Budget (OMB) Circular A-133. The State Auditor's Office contracted with KPMG LLP to perform the federal portion of the Statewide Single Audit. The federal portion included a review of compliance and controls over the State's federal awards and an audit of the Schedule of Expenditures of Federal Awards. The State Auditor's Office performed the financial portion of the Statewide Single Audit.

The scope of the financial portion of the Statewide Single Audit included an audit of the State's basic financial statements and a review of significant controls over financial reporting and compliance with applicable requirements. As required by the Single Audit

Act, this report also includes our Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.

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

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# Schedule of Findings and Questioned Costs

*State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2003*

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This chapter identifies the reportable conditions related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*.

Chapter 1-A

**Programmers at The University of Texas Southwestern Medical Center at Dallas Can Access Accounting System Data and Applications**

Reference No. 04-555-01

Programmers at The University of Texas Southwestern Medical Center at Dallas (Medical Center) are allowed to routinely access and make changes to the Medical Center's accounting system data and applications with limited approval and monitoring. Although nothing came to our attention indicating that errors or discrepancies had occurred because of this weakness, the access that programmers currently have could allow them to enter, change, or delete accounting transactions without timely detection. The State Auditor's Office previously reported this issue in 1999 (see *A Review of General Automation Controls at Selected State Agencies and Universities: Phase II*, SAO Report No. 99-045, August 1999). The Medical Center's accounting system contains key financial information used to manage day-to-day operations, including payments to vendors and financial reports.

Programmers can access the accounting system data and applications in two ways:

- Programmers can access and update the accounting system's data and applications directly when a user requests that the programmers change accounting data or fix processing problems. However, the Medical Center lacks formal policies or procedures for documenting these requests or for the approval of such requests. This could leave the Medical Center unable to fully explain or support its financial reports.

Although supervisors review programmer system access logs on a weekly basis, those logs do not contain sufficient details to determine what changes the programmers actually made. In addition, supervisors do not directly approve a programmer's access to the accounting system's data and applications. Instead, they receive e-mails simply informing them that a programmer has accessed the accounting system. Our review of the access log indicated that 16 programmers accessed the accounting system production environment 349 times in one four-month period we examined. In addition, we noted that in more than one-third of those instances, the e-mail notification was sent to the programmer actually making the changes rather than to another individual.

- Eleven programmers have user access to all menus of the accounting system, a level of access that is typically provided only to senior accounting personnel. This allows programmers to act as users and enter, change, or delete accounting transactions.

## Recommendations

The Medical Center should:

- Document users' requests to change accounting data or fix processing problems with a detailed description of what needs to be done. The Medical Center should also require that a supervisor or accounting department representative approve these requests. Request and approval documentation should then be retained.
- Explore stronger restrictions on programmers' access to the production environment. For example, direct approval from a supervisor could be required in place of the current e-mail notification process.
- Enhance the monitoring of all changes made to production data and the testing of changes made to applications. Programmers should be required to document the changes they make in sufficient detail for a supervisor to be able to review these changes. When possible, changes to the accounting application should be tested before implementation in production. This review, approval, and testing process should be documented.
- Review its practice of allowing 11 programmers access to all menus in the accounting system. If possible, the number of programmers with this access should be reduced. The Medical Center should also review whether programmers need access to all menus or whether their access can be restricted to read-only access or at least reduced from the current level.

## Management's Response

*The Medical Center agrees.*

- *We will implement a policy that requires the user of the application to make a detailed entry in the web based log requesting access of a programmer into production. A development manager will also make an entry approving that the programmer may access production with programming authority. If any data changes are required we will also require the user to enter that specific action request into the log. User requests will be maintained and available to programmers, managers, and users in this web based system. Managers will be responsible for reviewing the weekly production access reports and verifying that all accesses were properly logged in the user request application. Production access requests are currently linked to the user requests and the request form id number is required. Any actions in production will then be auditable with detailed descriptions of user requested actions taken in the web based log.*
- *If an action in production is taken during normal working hours we will require a manager's authorization prior to that action. If an action is taken outside of normal business hours then the programmer/analyst will be responsible to document that action and require the requesting user to document that action. The next business day a manager will make an entry into the web based user request log to document that the production access has been authorized and reviewed.*

- *We will enhance documentation of production program changes using the weekly production access log, web based user request log and program migration request form. Changes are documented in the change log at the top of every program source file. Migration change requests are required to reference the User Request Change log application. Details of programmer efforts in program modification and testing are included in the log. Production code migration only occurs with the authorization of a manager in an automated work flow. Production program changes may be scheduled in the future or requested immediately. Program version control and reversing migration request functionality is also part of the automated program migration request application.*
- *The number of programmer/analysts with any access rights to production programming will be decreased. We develop and maintain more than 40 applications and more than 20,000 modules in production and normally divide that responsibility across the development staff. We will reduce the number of programmer/analysts with full rights to the accounting application menus.*

*Implementation Date: May 31, 2004*

*Responsible Person: Vice President of Information Resources*

Chapter 1-B

### **Although the Department of Health Strengthened Certain Aspects of Its Financial Reporting, It Continues to Have Weaknesses that Reduce the Reliability of Its Financial Information**

Reference No. 04-555-02  
(Prior audit issue 03-555-01, 02-555-01, and 01-021)

In fiscal year 2002, we reported that the Department of Health (Department) had a material weakness in its financial reporting. Although the Department has significantly strengthened certain aspects of its financial reporting, it continues to have weaknesses that reduce the reliability of its financial information. As discussed below, the Department has not corrected all of its prior findings.

- In fiscal year 2002, the Department did not reconcile information in its internal accounting system, the Health and Human Services Administrative System (HHSAS), with information in the Uniform Statewide Accounting System (USAS) until after it submitted its fiscal year 2002 Annual Financial Report. The Department began reconciling HHSAS and USAS information for all appropriations for fiscal year 2003. As of November 26, 2003, it determined that of the \$300.9 million in total reconciling items, \$247.4 million (82 percent) did not require corrections. For the remaining reconciling items:
  - ♦ The Department had not completed the research and/or made corrections for approximately \$44.0 million (15 percent) of the reconciling items.
  - ♦ The Department had corrected approximately \$9.5 million (3 percent) of the reconciling items.

The Department has developed a process to extract and compare HHSAS and USAS cash transactions. (That process is comparable to the process previously used by the Comptroller of Public Accounts for the Department's fiscal year 2002 reconciliation.) Therefore, the Department can now run reports for the HHSAS/USAS reconciliation and use those reports to conduct the review of reconciling items. In addition, the Department created a Reconciliation Unit in August 2003, and this unit conducted the reconciliation for fiscal year 2003 with the assistance of contractors.

- The Department continues to lack formal policies and procedures for reconciling HHSAS with USAS. In addition, the Department continues to lack formal policies and procedures for making and approving the correcting entries associated with this reconciliation. It also does not have formal procedures to ensure consistency in the reconciliation process and to identify who is responsible for making and approving reconciling entries in USAS.

The Department uses an informal process to identify reconciling items, conduct research needed to clear these items, and make corrections. However, that process is not consistent among the various staff members performing reconciliations, and it is not always apparent why or how various staff members resolve discrepancies identified through their reconciliations. The Department has put other financial policies and procedures on the Department's intranet for employees to review.

- The beginning balances in HHSAS from fiscal year 2001 continue to be inaccurate and still need to be corrected. (The completion of the reconciliation described above and the correction of reconciling items should result in corrected fiscal year 2001 beginning balances.) Unlike in fiscal year 2002, the Department was able to generate a trial balance from HHSAS for fiscal year 2003. Nevertheless, having inaccurate beginning balances in HHSAS prevented the Department from using HHSAS to prepare its fiscal year 2003 Annual Financial Report. In addition, the process used to produce the trial balance had not been verified for accuracy. As a result, the Department used information in USAS to prepare most of its fiscal year 2003 Annual Financial Report. The Department was able to use HHSAS to determine accrued amounts for its fiscal year 2003 Annual Financial Report.
- In fiscal year 2002, the Department understated its accounts payable and corresponding expenditures in its Annual Financial Report by at least \$137 million. Although the Department improved its calculation of accounts payable in fiscal year 2003, it could still improve the accuracy of its accounts payable estimate. In its fiscal year 2003 Annual Financial Report, the Department reported \$102 million in accounts payable. It based that amount on disbursements it made during the first 45 days of fiscal year 2004. However, as of January 31, 2004, the Department recorded expenditures of nearly \$141 million for services received on or before August 31, 2003. This indicates that the Department could improve the accuracy of its reported accounts payable by developing another method for calculating that amount.

## Recommendations

The Department should:

- Reconcile HHSAS with USAS and internal subsystems on a monthly basis and verify that HHSAS contains accurate and complete financial information. The Department should proactively resolve appropriation year 2001 reconciling items.
- Establish formal policies and procedures for reconciling HHSAS with USAS and for making and approving the correcting entries. It should also ensure that the staff who perform reconciliations use consistent procedures to resolve discrepancies identified through the reconciliation process.
- Ensure that the trial balances it generates through HHSAS are accurate and that it corrects the beginning balances in HHSAS so that the Department can use HHSAS to prepare future Annual Financial Reports.
- Establish a more accurate process for estimating accounts payable for its Annual Financial Report.

## Management's Response

*TDH has made significant progress on reconciling information in its internal accounting system, the Health and Human Services Administrative System (HHSAS), with information in the Uniform Statewide Accounting System. As of March 12, 2004, TDH had an unreconciled balance for Fiscal Year 2003 of less than \$86,000. Correction of these items is pending a technical solution to update HHSAS. In addition, Staff have developed and implemented procedures for the monthly reconciliation of both cash and budget for Fiscal Year 2004. Staff will apply this same monthly reconciliation methodology to prior years and initial balances loaded into HHSAS to provide for an accurate trial balance by July, 2004.*

*Implementation Date: July 31, 2004*

*Responsible Person: Chief, Bureau of Financial Services (BFS)*

*As noted above, monthly reconciliation procedures have been developed. The monthly reconciliation procedures were finalized by staff in January 2004. These will be formally adopted as recommended by the State Auditor's Office. The procedures were routed to the General Ledger Manager in March 2004 and will be formalized by May 1, 2004. Periodic reviews will be performed to ensure staff are using consistent procedures to resolve discrepancies identified through the reconciliation process.*

*Implementation Date: May 1, 2004*

*Responsible Person: Chief, BFS*

*After reconciliation is performed back to the implementation of HHSAS, staff will be able to determine the accuracy of the initial fund loads to the system and if the current trial balance report is correct.*

*Implementation Date: July 31, 2004*

*Responsible Person: Chief, BFS*

*TDH calculated the accounts payable estimate for the Fiscal Year 2003 Annual Financial Report (AFR) based on the first 45 days of Fiscal Year 2004. TDH will continue to explore policies and procedures to improve the accuracy of estimated accounts payable reporting.*

*Implementation Date: October 30, 2004*

*Responsible Person: Chief, BFS*

Chapter 1-C

## **The Health and Human Services Commission Understated Its Fiscal Year 2003 Accounts Payable by \$617.9 Million**

Reference No. 04-555-03

The Health and Human Services Commission (Commission) understated its accounts payable by \$617.9 million in its fiscal year 2003 Annual Financial Report. This led to a material understatement of the Commission's liabilities and expenditures. After making the necessary adjustment to correct this error, the Commission's accounts payable for the State's Comprehensive Annual Financial Report was \$638.7 million. Understating accounts payable makes it appear as if the Commission had more funds available than it actually had at the end of fiscal year 2003.

The understatement occurred because the Commission failed to accrue Medicaid expenditures in its accounts payable. The Commission did not include Medicaid expenditures because of its misinterpretation of Rider 42, page II-57, the General Appropriations Act (78th Legislature, Regular Session), which authorized the Commission to expend Medicaid appropriations in a fiscal year without regard to date of service. However, Rider 42 relates to the appropriation year in which the Commission makes the actual Medicaid payment, not to whether the service was an obligation of the Commission at the end of the fiscal year. In addition, the Comptroller of Public Accounts' Accounting Policy Statement 18 states that agencies should record as accounts payable "amounts obligated for goods or services actually rendered or provided to the agency by the end of the reporting period, but for which the agency has not yet made payments."

### **Recommendations**

The Commission should:

- Accrue accounts payable related to Medicaid services in the fiscal year the obligation is incurred.



- Use forecasting methodologies (such as projecting based on historical expenditure data) when preparing accrual estimates for its Annual Financial Report. This should help enable the Commission to identify prior year expenditures that occur after the submission date of its Binding Encumbrance report.
- Reconcile its accruals and encumbrances with actual expenditure amounts reported in the Uniform Statewide Accounting System (USAS) to evaluate the accuracy of its accruals.

## Management's Response

*The Commission agrees that based on the GASB34 definition of accounts payable, there was an understatement of \$617,928,469 for liabilities and expenditures. However, \$391,930,834 of the \$617,928,469 are federal expenditures, there was an offsetting \$391,930,834 understatement in assets and revenue. The adjustment to Fund Balance was \$225,997,635 because the General Revenue (remaining asset amount) for these expenditures was not appropriated to the Commission until State Fiscal Year 2004.*

*The Director of Fund Accounting at the Commission has already calculated the adjustment and submitted it to the Comptroller of Public Accounts. The adjustment will be reflected in the 2003 Comprehensive Annual Financial Report for the State of Texas. The Commission used the same processes to calculate the adjustment that is being recommended.*

*The Commission would like to comment that there seems to be a conflict between Accounting Policy Statement 018 and GASB34. Accounting Policy Statement 018 states in the instructions "the annual requirement for binding encumbrances and payable includes entries in USAS for all previous appropriation years". The Commission feels our interpretation is in compliance with the policy statement. The expenditures were paid from 2004 appropriations for Medicaid public assistance in State Fiscal Year 2004.*

*Implementation Date: January 15, 2004*

*Responsible Person: Director of Fund Accounting*

## Auditor's Follow-up Comment

The Comptroller of Public Accounts' (Comptroller) Accounting Policy Statement 18 has not been updated to address the Commission's special authority provided by Rider 42 that allowed the Commission to pay fiscal year 2003 obligations from a subsequent year's appropriations. However, the Comptroller's 2003 *Reporting Requirements for Annual Financial Reports of State Agencies and Universities* (reporting requirements) provide guidance in this area. The reporting requirements specify that "Government fund expenditures should be recognized on the modified accrual basis. Expenditures (except for unmatured interest on general long-term debt) should be recognized in the accounting period in which the fund liability is incurred, if measurable." Therefore, the Commission's Annual Financial Report was

not in compliance with the reporting requirements for the fiscal year 2003 expenditures it paid from fiscal year 2004 appropriations.

Chapter 1-D

## **Prairie View A&M University Did Not Exercise Proper Control over Capital Assets**

Reference No. 04-555-04

Prairie View A&M University (University) did not have adequate controls to properly account for and report on its capital assets. Generally, capital assets are those assets, such as buildings and equipment, with an initial cost of more than \$5,000 and a useful life that exceeds one year. We identified seven buildings valued at \$92 million that the University misclassified by including them in its Construction in Progress account when it should have classified them as depreciable capital assets (specifically, under the Buildings account). This is significant because assets classified as Construction in Progress are not depreciated, but depreciable capital assets are. Such misclassifications result in the understatement of both depreciation expenses and depreciable capital assets and in the overstatement of Construction in Progress.

After we brought this matter to the University's attention, it corrected its Annual Financial Report prior to the submission deadline by decreasing its Construction in Progress account from \$119 million to \$26.4 million, increasing its Buildings account from \$92.3 million to \$183.9 million, and correcting the related depreciation expense and other accounts. However, there are still many projects included in the Construction in Progress account that were started more than five years ago, which indicates that additional corrections may be necessary. Investigating these projects and determining how to properly account for them will require a significant amount of time on the part of University property management staff. While University staff have indicated that they will make appropriate corrections, for each year that completed capital assets remain erroneously included in the Construction in Progress account, the University's depreciable capital assets will be understated and its expenses will be understated by the unrecorded depreciation.

Some of the relatively older projects included in the Construction in Progress account have not been reclassified in a timely manner because current property management staff have been unable to reconcile information in the University's accounting system with reports from the Texas A&M University System Facilities Planning and Construction department. Other projects were completed by the University's Physical Plant department during the tenure of former property managers, which makes it difficult to determine exactly what amounts should be capitalized. In addition, the University's property management staff have devoted their efforts to controlling equipment assets that are typically more vulnerable to disappearance and theft; as a result, they have limited their research on projects included in the Construction in Progress account.

In addition to misclassifying assets, the University is not adequately maintaining its capital asset listing. We tested 36 items on the University's capital asset listing and found the following:

- Three buildings in our sample (with a total cost of \$3.3 million and a current book value after depreciation of \$1.1 million) had been demolished. The University should have removed those buildings from the capital asset listing when they were demolished. One of those buildings had been demolished so long ago that another building currently stands in its place. The University's property management staff acknowledged that there may be other demolished buildings that are still included on its capital asset listing.
- We could not locate one piece of equipment in our sample, a "Logic Analyzer" with a cost of \$6,860. We located a second piece of equipment, an "X-ray Spectrometer," with a cost of \$285,000, but we could not verify that it was the listed item because its model number and tag number did not match those in the fixed asset system. The University says that the original unit was modified and upgraded, but the fixed asset system was not updated. Both items have been fully depreciated and, therefore, had a current book value of \$0.
- There were several instances of incomplete or incorrect data in the University's fixed asset system.

Keeping accurate records on capital assets is an important administrative function of the University and is critical to the accurate reporting of the University's financial position. In addition, inadequate controls over capital assets make the University more susceptible to fraud and theft.

## Recommendations

The University should:

- Review all records of capital assets to ensure that they are properly classified. The University should work with the Texas A&M University System Facilities Planning and Construction department and the University's Physical Plant department to reconcile differences regarding outstanding projects so that proper accounting can be determined.
- Comprehensively review the entire capital asset listing and ensure that all assets—including buildings, infrastructure, facilities, and equipment—can be located and that information in its capital asset system is complete, clear, and accurate. This should be in addition to the departmental equipment inventories that the University performs each year and the 100 percent verification of those inventories that property management staff are conducting in fiscal year 2004.

## Management's Response

- *In regards to the Construction in Progress account finding and recommendation to work with System Facilities and the University's Physical Plant department, we agree and are currently working with these offices to secure the final documentation to close these projects. We plan to have this task completed by the current fiscal year end and to have the projects properly classified on the 2004 annual financial report.*

- *We agree with the recommendation to conduct a comprehensive review of our entire capital asset listing and to make any necessary corrections to ensure that all assets are located and that all information in the capital asset system is complete and accurate. We are in the process of performing this task. We plan to complete this process by current fiscal year end.*

*Implementation Date: August 31, 2004*

*Responsible Person: Manager of Accounting*

Chapter 1-E

## **The Water Development Board Lacks Adequate Controls over Its Automated Financial Systems**

Reference No. 04-555-05

The Water Development Board (Board) does not consistently and promptly terminate users' access rights to its automated financial systems, nor does it require users to regularly change the passwords they use to access the Board's financial systems and local area network. We did not identify any financial discrepancies that resulted from these weaknesses. However, weak controls over access to financial systems increase the risk that unauthorized changes could be made to financial information. This could allow for misappropriation of agency assets and result in the material misstatement of financial reports.

**The Board does not always promptly terminate users' access rights to its financial systems.**

We identified two former employees who had access rights to the Board's Financial Information Systems (FIS) for more than two months after the termination of their employment. In addition, we identified another former contract employee who had access to FIS for an indeterminate period after the employee's termination. Not terminating access promptly increases the risk that unauthorized changes could be made to the Board's financial information.

Texas Administrative Code, Title 1, Section 202.7, states that "...access to information resources shall be managed to ensure authorized use" and that "A user's access authorization shall be appropriately modified or removed when the user's employment or job responsibilities within the agency change."

The Board does not have adequate access termination procedures and relies only on e-mail requests to grant and terminate access to FIS, its general ledger accounting system (Micro Information Products or MIP), and the Uniform Statewide Accounting System (USAS). Its human resources checklist for termination does not cover terminating user access to financial systems.

**The Board does not require its employees to regularly change the passwords they use to access its financial systems and local area network or to use password naming conventions.**

The Board does not require its employees to regularly change the passwords they use to access FIS, MIP, and the Board's local area network. Additionally, the Board has

no naming conventions for establishing valid and secure passwords. This increases the risk that unauthorized users could modify information.

An external contractor also noted significant password administration weaknesses in a vulnerability audit it conducted at the Board in January 2001. However, the Board has not yet addressed the contractor's recommendations. The contractor recommended that the Board implement the following password requirements:

- Require users to change passwords every 90 days.
- Require users to establish passwords that contain at least six characters and combinations of letters, numbers, and symbols that are not easily guessed.
- Prohibit users from storing passwords in password files on their computers.

Texas Administrative Code, Title 1, Section 202.7, specifies that "Information resource systems which use passwords shall be based on industry best practices on password usage and documented agency security risk management decisions." Guidance from the Department of Information Resources also specifies that agency employees should routinely change their passwords.

## Recommendations

The Board should:

- Implement a formal procedure for granting and revoking access to its financial systems. This procedure should also identify the level of access requested. Employees should acknowledge receipt and understanding of the procedure by signing a statement to that effect.
- Implement a formal password policy that incorporates recommendations from the external contractor's recommendations, requirements of the Texas Administrative Code, and Department of Information Resources guidance. The Board also should communicate its password policy to all employees and ask employees to sign password policy statements.

## Management's Response

*Management agrees.*

### Granting Access

*Currently, Programming and Application Development staff are working on developing a FIS Request Application that will require all staff to go through a formal process to request access to the financial system.*

- *The formal procedures will be implemented utilizing the agency's email system.*
- *All requests and approval emails will be archived for documentation and audit purposes.*

*Fiscal Services staff are working on formalizing existing procedures for requesting and approving access to USAS and MIP. Essential parts of the formal process will include:*

- *A written procedure outlining the steps to be followed for granting access;*
- *A signed acknowledgement of the receipt and understanding of the procedure; and*
- *A form for requesting the necessary access, with places for all information necessary to grant access to the requested system(s) and signoff by the requesting supervisor.*

#### *Revoking Access*

*The agency's exit process includes a formal checklist. Now included is an item to remove accounts to all financial systems (FIS, MIP, USAS) as well as all other network access.*

*Implementation date: August 31, 2004*

*Responsible Person(s): FIS - Director of Programming and Applications*

*MIP, USAS - Director of Fiscal Services*

#### *Password Policy*

*The Board is in the final stages of updating all IT Security Policies to include the Password Policy. This policy will be implemented, along with all IT Security Policies, as updates of these policies are finalized. Furthermore, these IT Security Policies are modified versions of the IT Security Templates published by the Department of Information Resources, which complies with Texas Administrative Code requirements.*

*Once these policies have been approved by the Executive Administrator, they will be communicated to the agency as well as posted to the agency's intranet. Educational sessions will be held to inform staff of these updated requirements.*

*At the present time, all new employees are required to sign a statement acknowledging receipt of, and having read, all IT Security Policies. The Information Resources Manager will work with the Director of Human Resources to ensure all staff sign password policy statements, as recommended by SAO.*

*Implementation date: August 31, 2004*

*Responsible Person: Director of Information Technology Division*

## The Texas Education Agency Should Continue Strengthening Its Foundation School Program Reconciliation Process

Reference No. 04-555-06

In April 2003, we reported that the Texas Education Agency (Agency) did not reconcile school district payment amounts calculated by its Foundation School Program system with school district payments actually made through the Uniform Statewide Accounting System (USAS). (See *An Audit Report on the Texas Education Agency's Administration of the Foundation School Program*, SAO Report No. 03-033, April 2003.) Although the Agency reconciled those payments in June 2003 and August 2003, it should further enhance its Foundation School Program reconciliation process by reconciling other funding that is processed through the Foundation School Program system. Reconciling funding that flows through that system with payments made through USAS is important because it helps to ensure that school districts receive correct payment amounts.

The school district payments that the Agency reconciled in June 2003 and August 2003 represented approximately \$8.4 billion (78 percent) of total state funding to school districts for fiscal year 2003. However, the Agency is not reconciling other forms of state funding processed by the Foundation School Program system. Specifically, the Agency is not reconciling:

- Funding from the Available School Fund, which represented \$1.4 billion (13.25 percent) in funding to school districts for fiscal year 2003.
- Adjustments that the Agency makes to school district payments through the settle-up process. (The settle-up process is the process that the State uses to adjust school district funding after final property tax data, audited tax collections, and student attendance data have been submitted.) While the total of all settle-up adjustments is not a significant portion of overall funding, the individual settle-up adjustments have the potential to significantly affect an individual school district's payments.

### Recommendation

The Agency should enhance its Foundation School Program reconciliation process by reconciling funding from the Available School Fund and adjustments from the settle-up process.

### Management's Response

*Texas Education Agency agrees with the above recommendation. The agency will reconcile the current Foundation School Program payments and Available School Fund payments as well as the settle-up adjustments made during FY 2004. The payments will be reconciled at the county district level between the State Funding system and the official books of record of the agency (e.g., ISAS). The reconciliations will be completed on a fiscal quarterly basis starting with the period ending*

*February 29, 2004. They should be completed within 45 days of the end of the quarter.*

*Implementation Date: April 15, 2004*

*Responsible Person: Director of Accounting*



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

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For fiscal year 2003, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Year Ended August 31, 2003*, by KPMG LLP, dated February 23, 2004.

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# Summary Schedule of Prior Audit Findings

*State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2003*

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## Summary Schedule of Prior Audit Findings

Federal regulations (Office of Management and Budget Circular A-133) state that “the auditee is responsible for follow-up and corrective action on all audit findings.” As part of this responsibility, the auditees report the corrective actions they have taken for the findings reported in the *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2001* (SAO Report No. 02-555, May 2002) and the *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002* (SAO Report No. 03-555, April 2003). The Summary Schedule of Prior Audit Findings (year ended August 31, 2003) has been prepared to address these responsibilities. Table 1 describes the findings from SAO Report No. 03-555 for which corrective action has been taken.

Table 1

Schedule of Prior Year Findings for which Agencies Have Taken Corrective Action			
Agency	Finding (Description from the <i>State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002</i> )	Reference (Number in SAO Report No. 03-555)	Status
Health and Human Services Commission	The Health and Human Services Commission did not reconcile its internal accounting system with USAS.	03-555-02 Initial year written: 2003	Corrective action was taken.
General Land Office and Veterans' Land Office	The General Land Office and Veterans' Land Board lacked up-to-date, comprehensive, written procedures for processing and recording loans and contract accounts receivable.	03-555-03 Initial year written: 2003	Corrective action was taken.
General Land Office and Veterans' Land Board	The General Land Office and Veterans' Land Board lacked sufficient controls to ensure the accuracy of land contract accounts receivable data.	03-555-04 Initial year written: 2003	Corrective action was taken.
General Land Office and Veterans' Land Board	The General Land Office and Veterans' Land Board overstated Interest Receivable for Housing Mortgages.	03-555-05 Initial year written: 2003	Corrective action was taken.

## The Department of Health Continues to Have Weaknesses in Financial Reporting

Reference No. 03-555-01 and 02-555-01  
(Prior audit issue - SAO Report Numbers 03-555, 02-555, and 01-021)

A summary of the status of the Department of Health's (Department) prior findings is as follows:

Initial Year Written:	2000
Status:	Partially Implemented

U.S. Department of Health and Human Services
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- The Department has partially addressed the issues we identified in our prior audit (specifically, finding number 03-555-01 in our prior audit report). The prior year issues that the Department has not fully addressed are also reported as current year finding number 04-555-02 in this report.
- KPMG LLP did not repeat its fiscal year 2002 material control weakness finding at the Department in its audit report for fiscal year 2003.
- The Department's internal auditor has not yet verified whether the Department has corrected the Health and Human Services Administrative System (HHSAS) implementation issues the internal auditor had previously identified.

Of the four outstanding issues identified in the 2001 and 2002 prior audits, the Department has addressed two issues and partially addressed two issues. Specifically:

- The Department has addressed security control issues identified in its internal accounting system, HHSAS. The Department's internal auditor determined that the Department has made significant progress in ensuring the security of HHSAS and its data.
- The Department has addressed its failure to submit to the federal government indirect cost-recovery plans to support its indirect cost rates for fiscal years 2002 through 2004. On January 12, 2004, the Department signed an Indirect Cost Recovery Plan agreement with the U.S. Department of Health and Human Services. That agreement finalized the fiscal year 2002 and 2003 indirect cost rates and changed the fiscal year 2004 rates to provisional/final rates.
- The Department has partially addressed an issue regarding the interest liability it incurred when it made expenditure adjustments that changed a transaction's method of financing from federal to state funds. The Department did not make any significant expenditure adjustments that changed a transaction's method of financing from federal to state funds in fiscal year 2003. Therefore, it did not incur a future state interest liability.

The Department properly recorded the 15 expenditure transfers we noted in a prior audit report (*An Audit Report on the Department of Health's Implementation of a Business Improvement Plan*, SAO Report No. 03-023, March 2003) in its 2003 *Cash Management Improvement Act* report. However, it still did not calculate the related interest liability owed to the federal government

correctly. It erroneously calculated a \$642 interest liability from the date the transfer occurred, not from date the Department drew down the funds from the federal government (as instructed by the U.S. Department of the Treasury Financial Management Services). The correct interest liability that the Department owes to the federal government could not be calculated because the original draw down dates (occurring in appropriation year 1997) for one transfer totaling \$2,046,337 could not be determined. However, using an August 31, 1997, estimate for the draw down date, the correct interest liability is approximately \$298,000 (rather than \$642).

The Department should add the interest liability estimate of \$298,000 to the prior year estimate of \$762,000 (for a total of \$1,060,000) and include the total amount as a prior period adjustment in its December 31, 2004, *Cash Management Improvement Annual Report*. The Department should also work with the Comptroller of Public Accounts and the U.S. Department of the Treasury Financial Management Services to ensure that it (1) calculates its interest liability using the date it drew down the funds and (2) includes the interest liability it did not report for 2002 and 2003 in its 2004 *Cash Management Improvement Act Annual Report*.

- The Department has partially addressed an issue regarding the incorrect coding of expenditures. Following the June 1, 2003, reorganization of its accounts payable unit, the Department improved the accuracy of its expenditure coding. Our prior year testing had identified a 43 percent error rate in expenditure coding. In fiscal year 2003, the Department incorrectly coded 3 (10 percent) of the 29 expenditures we tested. In addition, the transactions that were coded incorrectly in 2003 were coded before the reorganization of the Department's accounts payment unit; the seven 2003 transactions we tested that were coded after the reorganization were all coded correctly.

## Corrective Action and Management's Responses

Additional responses can be found in the Schedule of Findings and Questioned Costs.

### ***Interest Liability***

*A Cash Management Improvement Act (CMIA) report was submitted in December 2003 to the Comptroller of Public Accounts (CPA) that accurately reflected the expenditure transfer vouchers processed by TDH to move expenditures from federal to state funds. At that time, TDH was advised that the interest was calculated from the date of the expenditure transfer. The CPA has now provided new guidance, and TDH will work with them to submit an accurate accounting of interest liability on the CMIA report submitted in December 2004.*

*Implementation Date: December 31, 2004*

*Responsible Person: Chief, Bureau of Financial Services (BFS)*

### ***Miscoded Expenditures***

*In June 2003, TDH centralized the Accounts Payable staff to provide better accounting and controls for expenditures. This centralization effort included additional training for staff on travel and purchasing rules, invoice tracking and established policies and procedures. TDH appreciates acknowledgements of the SAO of improvements since this centralization. TDH is working to correct any miscoded expenditures prior to the centralization. TDH has run queries and reports to identify expenditure transactions that may have been miscoded. Accounts Payable staff are reviewing these reports and processing corrections as needed.*

*Implementation Date: May 1, 2004*

*Responsible Person: Chief, BFS*

Chapter 3-B

## **The Texas Education Agency Should Address Certain Information Technology Issues to Ensure that It Continues to Properly Administer the Foundation School Program**

Reference No. 03-555-07 and 03-033

The Texas Education Agency (Agency) has partially addressed one of the five issues we identified in our April 2003 audit report (*An Audit Report on the Texas Education Agency's Administration of the Foundation School Program*, SAO Report No. 03-033). The Agency is in the process of addressing the remaining four issues. In the corrective action plan it developed in response to our April 2003 report, the Agency stated that it would address all but one of the issues we identified during fiscal year 2004; as discussed below, it plans to address the one remaining issue during the next biennial funding cycle.

### **Corrective Action**

- In April 2003, we reported that the Agency did not reconcile school district payment amounts calculated by its Foundation School Program system with school district payments actually made through the Uniform Statewide Accounting System (USAS). While it has partially addressed this issue by conducting reconciliations in June 2003 and August 2003, we are recommending that the Agency further enhance its reconciliation process by including other funding sources flowing through the Foundation School Program system in this reconciliation.
- In April 2003, we reported that the Agency had not properly documented all applications and data used in its Foundation School Program allocation and payment processes. The Agency has not yet addressed this issue. However, it is developing a new Foundation School Program automated system, and it reports that the new system will meet all documentation standards applicable to any agency software development project. The Agency has also begun maintaining a complete set of applications used for the student count projections for the 78th Legislative Session.



- In April 2003, we reported that the Agency needed to further restrict access to data stored on its network server. Although the Agency has not yet addressed this issue, its implementation of reconciliations for Foundation School Program payments is a compensating control that mitigates the risk associated with this issue. The Agency has not yet implemented our recommendation to restrict access to all key inputs of the Foundation School Program. We also made an informal recommendation to management to further restrict access to property tax data.
- In April 2003, we reported that the Agency needed to strengthen separation of duties in the processing of key data inputs to the funding allocation process. Although the Agency has not yet addressed this issue, its development of a new Foundation School Program is intended to provide a cleaner separation of duties that will allow for more control.
- In April 2003, we reported weaknesses in the Agency's process for allowing school districts to update student count estimates. Although it has not yet addressed this issue, the Agency plans to address these weaknesses in the next biennial funding cycle.

Agency management agreed with the status of corrective action described above.

#### Chapter 3-C

### **Specific Improvements Are Needed in the Comptroller of Public Accounts' Access and Security Controls over TEXNET**

Reference No. 03-555-06

In fiscal year 2002, we reported that the Comptroller of Public Accounts (Comptroller) had adequate controls to ensure the reliability of TEXNET (the State's financial network that receives electronic funds transfer payments from taxpayers). However, we identified certain opportunities to strengthen that system's access and security controls. The Comptroller has begun to address or has implemented all of the recommendations we made in our prior report.

#### **Corrective Action**

- In fiscal year 2002, we reported that Comptroller staff did not review the TEXNET Login Fail Count report or the on-line log of updates made to TEXNET production programs. This could allow unauthorized individuals to access TEXNET data and modify TEXNET programs. The Comptroller has now updated its procedures to require monthly reviews of the automated Login Fail Count report, which identifies individuals whose attempts to access TEXNET data have failed. The Comptroller also reports that it is redesigning processes to ensure that it reviews the on-line log that lists the updates programmers have made to TEXNET production programs.
- In fiscal year 2002, we reported that the Comptroller (1) does not require that an individual who is independent of programming move new or modified TEXNET programs into the production environment and (2) lacks formal documentation

for TEXNET programs. The Comptroller reports that it is installing new software to limit the ability of programmers to move TEXNET programs into the production environment, which will help prevent them from making unauthorized changes to programs.

- In fiscal year 2002, we reported that the Comptroller needed to strengthen password protection for the application that creates a file of TEXNET data for submission to the Uniform Statewide Accounting System (USAS). The Comptroller reports that it has begun rewriting the TEXNET programs and that this will allow it to strengthen password protection for Crevou, the application that creates the TEXNET data file for submission to USAS.
- In fiscal year 2002, we reported that access to the application that notifies Production Control that a batch processing job is ready to transmit TEXNET payments to USAS is not properly restricted. The Comptroller reports that the rewriting of TEXNET programs currently underway will allow it to improve access controls over that application.
- In fiscal year 2002, we reported that the Comptroller did not properly control access to its Funds Allocation Network (FAN) Excel spreadsheet, which three Treasury divisions used to track the flow of funds and to balance banks' postings with the Comptroller's reports. The Comptroller has implemented automated controls to safeguard the FAN data.

Comptroller management agreed with the status of corrective action described above.

# Independent Auditor's Report

*State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2003*

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## ***Summary of Auditor's Results***

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### **Financial Statements**

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

### **Federal Awards**

For fiscal year 2003, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Year Ended August 31, 2003*, by KPMG LLP, dated February 23, 2004.



February 23, 2004

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

The Honorable Rick Perry, Governor  
and  
Members of the Texas Legislature  
State of Texas

Ladies and Gentlemen:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Texas as of and for the year ended August 31, 2003, and have issued our report thereon dated February 23, 2004. Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

### Compliance

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

### Internal Control over Financial Reporting

In planning and performing our audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters that come to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The

accompanying schedule of findings and questioned costs describes reportable conditions for The University of Texas Southwestern Medical Center at Dallas, the Department of Health, the Health and Human Services Commission, Prairie View A&M University, the Water Development Board, and the Texas Education Agency.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

### Work Performed by Other Auditors

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

Entities Audited by Other Auditors	Scope of Work Performed
Texas Guaranteed Student Loan Corporation	An audit of the financial statements of each major fund of the Texas Guaranteed Student Loan Corporation was conducted as of and for the years ended September 30, 2003 and 2002.
Texas Local Government Investment Pool	An audit of the statements of fiduciary net assets of the Texas Local Government Investment Pool, an investment trust fund of the State of Texas, was conducted as of and for the years ended August 31, 2003 and 2002.
Texas Local Government Investment Pool Prime	An audit of the statement of fiduciary net assets and the related statement of changes in fiduciary net assets of the Texas Local Government Investment Pool Prime, an investment trust fund of the State of Texas, was conducted as of and for the year ended August 31, 2003.
Texas Prepaid Higher Education Tuition Board	An audit of the financial statements of the business-type activities, the discretely presented component unit, each major fund, and the fiduciary fund information was conducted as of and for the year ended August 31, 2003.
Employees Retirement System	An audit of the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information was conducted as of and for the year ended August 31, 2003. An audit was also conducted for the combining statements of fiduciary net assets and changes in fiduciary net assets of the pension plans administered by the Employees Retirement System as of August 31, 2003.
Department of Housing and Community Affairs	An audit of the financial statements of the governmental activities, business-type activities, major funds, remaining fund information, and supporting schedules was conducted as of and for the year ended August 31, 2003.
Texas Lottery Commission	An audit of the financial statements of the governmental activities, the business-type activities, each major fund, and fiduciary fund information was conducted as of and for the years ended August 31, 2003 and 2002.
Permanent University Fund	An audit of the statements of net investment assets and the summary of investment securities; related statements of operations and changes in net investment assets; and the schedule of changes in cost of investments and investment income was conducted as of and for the year ended August 31, 2003.
The University of Texas System Long-Term Fund	An audit of the statement of net assets and related statements of operations, changes in net assets, cash flows, and financial highlights was conducted as of and for the year ended August 31, 2003.
The University of Texas System Short-Intermediate Term Fund	An audit of the statement of net assets and the schedule of investment in securities, and the related statements of operations, changes in net assets, and cash flows was conducted as of and for the year ended August 31, 2003.

Entities Audited by Other Auditors	Scope of Work Performed
The University of Texas System Permanent Health Fund	An audit of the statement of net assets, and related statements of operations, changes in net assets, cash flows, and financial highlights was conducted as of and for the year ended August 31, 2003.
The University of Texas System General Endowment Fund	An audit of the statement of net assets and the summary of investment in securities, and the related statements of operations, changes in net assets, cash flows, and financial highlights was conducted as of and for the year ended August 31, 2003.
Department of Transportation Turnpike Authority	An audit of the statement of net assets as of August 31, 2003, and the related statements of revenues, expenses, and changes in net assets, and cash flows of the period from inception to August 31, 2003 was conducted.
The University of Texas M. D. Anderson Cancer Center	An audit of the consolidated balance sheets as of August 31, 2003 and 2002 and the related consolidated statements of revenues, expenses, changes in net assets, and cash flows for the years then ended was conducted.

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

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

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

- *A Report on the Teacher Retirement System's Pension and Retiree Health Insurance Plans* (SAO Report No. 04-017, December 2003)
- *A Report on the Fire Fighters' Pension Commissioner's Texas Statewide Emergency Services Personnel Retirement Fund for Fiscal Year 2003* (SAO Report No. 04-021, February 2004)
- *A Report on the Permanent School Fund* (SAO Report No. 04-022, February 2004)

This report is intended solely for the information and use of the Governor, the Legislature, audit committees, boards and commissions, management, and all federal awarding agencies and pass-through entities from which federal 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



# Appendices

Appendix 1

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

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### **Objective**

Our objective was to determine whether the State's basic financial statements accurately reflect the balances and activities for the State of Texas for the fiscal year ended August 31, 2003.

The Statewide Single Audit is an annual audit for the State of Texas. It is conducted so that the State complies with the Single Audit Amendments of 1996 and the Office of Management and Budget (OMB) Circular A-133. The State Auditor's Office contracted with KPMG LLP to perform the federal portion of the Statewide Single Audit. The federal portion included a review of compliance and controls over the State's federal awards and an audit of the Schedule of Expenditures of Federal Awards. The State Auditor's Office performed the financial portion of the Statewide Single Audit.

### **Scope**

The scope of the financial portion of the Statewide Single Audit included an audit of the State's basic financial statements for fiscal year 2003 and a review of significant controls over financial reporting and compliance with applicable requirements.

### **Methodology**

Our methodology consisted of collecting information, conducting data analysis, performing selected audit tests and other procedures, and analyzing and evaluating the results against established criteria.

Information collected included the following:

- Agency and institution of higher education policies and procedures
- Agency and institution of higher education systems documentation
- Agency and institution of higher education accounting data
- Agency and institution of higher education year-end accounting adjustments
- Agency and institution of higher education fiscal year 2003 Annual Financial Reports

Procedures and tests conducted included the following:

- Evaluating automated systems controls
- Performing analytical tests of account balances
- Performing detail tests of vouchers

- Applying computer assisted auditing techniques to accounting data
- Comparing agency and institution of higher education accounting practices with Comptroller of Public Accounts reporting requirements

Information systems reviewed included the following:

- Agency and institution of higher education internal accounting systems
- Uniform Statewide Accounting System (USAS)
- State Property Accounting (SPA) system
- Uniform Statewide Payroll/Personnel System (USPS)
- Standardized Payroll/Personnel Reporting System (SPRS)

Criteria used included the following:

- Texas statutes
- Texas Administrative Code
- General Appropriations Act (77th Legislature)
- The Comptroller of Public Accounts' policies and procedures
- The Comptroller of Public Accounts' *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*
- Generally accepted accounting principles (GAAP)

### Other Information

We conducted fieldwork from October 2003 through February 2004. Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

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

- |   |                           |
|---|---------------------------|
| ▪ William J. Morris, CPA (Project Manager)    | ▪ Fred Bednarski III      |
| ▪ Joe Curtis, CPA (Assistant Project Manager) | ▪ Robert Bollinger, CPA   |
| ▪ Rodney Almaraz, CPA, CISA                   | ▪ Sharon Brantley         |
| ▪ Kathy Aven, CIA                             | ▪ Sharon Carney, CPA, MBA |
| ▪ Ileana Barboza, MBA                         | ▪ Anthony Chavez          |
| ▪ Agnes Barnes, CPA                           | ▪ Michael Clayton, CPA    |
| ▪ Beverly Bavousett, CPA                      | ▪ Jodi Cline              |
|   | ▪ Rachel Cohen, CPA       |
|   | ▪ Lisa R. Collier, CPA    |

- Olin Davis, MBA
- Romeo Diaz
- Dean Duan, CISA
- Michelle A. Feller
- Ricardo A. Garcia, MPAff
- Michael Gieringer
- Elisabeth Godwin
- Kelton M. Green, CPA
- William Hurley, CPA
- C. Y. Ihekwoaba, CPA, CFE
- Joyce Inman, CGFM
- Robert G. Kiker
- Carla Kleinwachter, CIA
- Carmelita Lacar, MBA, PhD
- Gary Leach, CQA
- Ray McGettrick, FCA
- Veda Mendoza, CIA
- Dana Musgrave, MBA
- Jon Nelson, CISA
- Jenay Oliphant
- Ann Elizabeth Paul, CPA
- Patricia Perme, CPA
- Walton Persons, CPA
- Tony Rose, CPA, CGFM
- Juan R. Sanchez, MPA
- Stephanie Sherrill
- Sarah E. Slaughter, CPA
- Mary Stauffer
- Jim Timberlake
- Fred Tracy, CPA
- Rene Valadez
- Max Viescas, CPA
- Joe White, CFA
- Stacey Williams
- Mary Wise, CPA
- Bill Wood, CPA
- Michael Yokie, CISA
- Sheila DeLeon (Federal Coordinator)
- Leslie Ashton, CPA (Quality Control Reviewer)
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Chuck Dunlap, CPA (Quality Control Reviewer)
- Worth Ferguson, CPA (Quality Control Reviewer)
- J. Scott Killingsworth, CIA (Quality Control Reviewer)
- Susan A. Riley, CPA (Audit Manager)
- Frank Vito, CPA (Audit Director)

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

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We audited certain financial accounts at the following state agencies and institutions of higher education:

- Comptroller of Public Accounts
- Department of Health
- Department of Human Services
- Department of Transportation
- General Land Office and Veterans' Land Board
- Health and Human Services Commission
- Prairie View A&M University
- Texas A&M University
- Texas A&M University at Galveston
- Texas A&M University System Administrative and General Offices
- Texas Education Agency
- Texas Tech University
- Texas Workforce Commission
- The University of Texas at Arlington
- The University of Texas at Austin
- The University of Texas Health Science Center at Houston
- The University of Texas Medical Branch at Galveston
- The University of Texas Southwestern Medical Center at Dallas
- The University of Texas System Administrative and General Offices
- Water Development Board

Copies of this report have been distributed to the following:

### **Legislative Audit Committee**

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair  
The Honorable Tom Craddick, Speaker of the House, Joint Chair  
The Honorable Steve Ogden, Senate Finance Committee  
The Honorable Thomas “Tommy” Williams, Member, Texas Senate  
The Honorable Talmadge Heflin, House Appropriations Committee  
The Honorable Ron Wilson, House Ways and Means Committee

### **Office of the Governor**

The Honorable Rick Perry, Governor

### **Comptroller of Public Accounts**

The Honorable Carole Keeton Strayhorn, Comptroller of Public Accounts  
Mr. Billy Hamilton, Deputy Comptroller

### **Department of Health**

Chair and Members of the Board of Health  
Dr. Eduardo J. Sanchez, Commissioner of Health

### **General Land Office and Veterans’ Land Board**

The Honorable Jerry Patterson, Land Commissioner  
Members of the School Land Board

### **Health and Human Services Commission**

Mr. Albert Hawkins, Commissioner

### **Prairie View A&M University**

Chair and Members of the Texas A&M University System Board of Regents  
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Dr. George C. Wright, President, Prairie View A&M University

### **Texas Education Agency**

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